

In the Matter of:)
) Docket No.: R2006-1
POSTAL RATE AND FEE CHANGES)

Date: August 30, 2006
Place: Washington, D.C.
Pages: 5046 through 5288

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POSTAL RATE COMMISSION

In the Matter of:)
) Docket No.: R2006-1
POSTAL RATE AND FEE CHANGES)

Suite 200
Postal Rate Commission
901 New York Avenue, N.W.
Washington, D.C.

Volume 17
Wednesday, August 30, 2006

The above-entitled matter came on for hearing pursuant to notice, at 9:32 a.m.

BEFORE:

HON. GEORGE A. OMAS, CHAIRMAN
HON. DAWN A. TISDALE, VICE-CHAIRMAN
HON. TONY HAMMOND, COMMISSIONER
HON. RUTH Y. GOLDWAY, COMMISSIONER
HON. MARK ACTON, COMMISSIONER

APPEARANCES:

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C O N T E N T S

WITNESSES APPEARING:

DONALD J. O'HARA

<u>WITNESSES:</u>	<u>DIRECT</u>	<u>CROSS</u>	<u>REDIRECT</u>	<u>RECROSS</u>	<u>VOIR DIRE</u>
Donald J. O'Hara	5052	--	--	--	--
by Mr. Olson	--	5128	--	--	--
by Mr. Volner	--	5143	--	--	--
by Mr. Straus	--	5159	--	--	--
by Mr. Horwood	--	5178	--	--	--
by Mr. Baker	--	5183	--	--	--
by Ms. Dreifuss	--	5210	--	--	--
by UPS	--	5240	--	--	--
by Valpak	--	5245	--	--	--
by Advo	--	5273	--	--	--

<u>DOCUMENTS TRANSCRIBED INTO THE RECORD</u>	<u>PAGE</u>
Corrected designated written cross-examination of Donald J. O'Hara, USPS-T-31	5055
Responses of Witness O'Hara to Valpak/USPS-T31-1 and 7 through 9, NAA/USPS-T-31-9, and POIR No. 1, Question 12	5106

E X H I B I T S

<u>EXHIBITS AND/OR TESTIMONY</u>	<u>IDENTIFIED</u>	<u>RECEIVED</u>
Corrected final direct testimony of Donald J. O'Hara on behalf of the United States Postal Service, USPS-T-31	5051	5053
Corrected designated written cross-examination of Donald J. O'Hara, USPS-T-31	5054	5054
Responses of Witness O'Hara to Valpak/USPS-T31-1 and 7 through 9, NAA/USPS-T-31-9, and POIR No. 1, Question 12	5105	5105

P R O C E E D I N G S

(9:32 a.m.)

CHAIRMAN OMAS: Good morning. Today is our final day of hearings to receive testimony from the Postal Service witnesses in support of Docket No. R2006-1, Request for Rate and Fee Changes.

Does anyone have any procedural matter they would like to discuss at this juncture?

(No response.)

CHAIRMAN OMAS: Hearing none, Mr. Tidwell?

MR. TIDWELL: Good morning, Mr. Chairman.

CHAIRMAN OMAS: Would you identify your witness so I can swear him in?

MR. TIDWELL: The Postal Service calls Donald O'Hara to the stand.

CHAIRMAN OMAS: Raise your right hand.

Whereupon,

DONALD J. O'HARA

having been duly sworn, was called as a witness and was examined and testified as follows:

CHAIRMAN OMAS: Please be seated.

(The document referred to was marked for identification as Exhibit No. USPS-T-31.)

//

1 DIRECT EXAMINATION

2 BY MR. TIDWELL:

3 Q Mr. O'Hara, on the table in front of you are
4 two copies of a document entitled Final Direct
5 Testimony of Donald J. O'Hara on Behalf of the United
6 States Postal Service. Was that document prepared by
7 you or under your supervision?

8 A Yes, it was.

9 Q If you were to provide the contents of that
10 document as your oral testimony today, would it be the
11 same?

12 A Yes, it would.

13 Q I would note for the record that it is the
14 revised August 25, 2006, version that has been
15 designated as USPS-T-31.

16 Are there any library references associated
17 with your testimony?

18 A Yes. There's a library reference of
19 workpapers which is No. 174.

20 Q And that document as well was prepared by
21 you and under your supervision?

22 A Yes, it was.

23 MR. TIDWELL: Mr. Chairman, the Postal
24 Service would then like to move into evidence the
25 direct testimony of Witness O'Hara and his associated

1 library references.

2 CHAIRMAN OMAS: Is there any objection?

3 (No response.)

4 CHAIRMAN OMAS: Hearing none, I will direct
5 counsel to provide the reporter with two copies of the
6 corrected direct testimony of Donald J. O'Hara.

7 That testimony is received into evidence.
8 However, as is our practice, it will not be
9 transcribed.

10 (The document referred to,
11 previously identified as
12 Exhibit No. USPS-T-31, was
13 received in evidence.)

14 CHAIRMAN OMAS: Mr. O'Hara, have you had an
15 opportunity to examine the cross-examination packet
16 that was provided to you this morning?

17 THE WITNESS: Yes, I have.

18 CHAIRMAN OMAS: If those questions in that
19 packet were posed to you orally today, would your
20 answers be the same as those you have provided
21 previously in writing?

22 THE WITNESS: Yes, they would.

23 CHAIRMAN OMAS: Are there any corrections or
24 additions you would like to make to those answers?

25 THE WITNESS: There is one page where the

1 caption at the top was wrong. I think my counsel has
2 marked it here and has replaced it, so I guess as the
3 package stands it's okay. It was just changed this
4 morning.

5 CHAIRMAN OMAS: Thank you.

6 With that, counsel, would you please provide
7 two copies of the corrected designated written cross-
8 examination of Witness O'Hara to the reporter?

9 That material is received into evidence and
10 will be transcribed into the record.

11 (The document referred to was
12 marked for identification as
13 Exhibit No. USPS-T-31 and was
14 received in evidence.)

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BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

Postal Rate and Fee Changes, 2006

Docket No. R2006-1

DESIGNATION OF WRITTEN CROSS-EXAMINATION
OF UNITED STATES POSTAL SERVICE
WITNESS DONALD J. O'HARA
(USPS-T-31)

<u>Party</u>	<u>Interrogatories</u>
American Bankers Association and National Association of Presort Mailers	ABA-NAPM/USPS-T31-1 GCA/USPS-T31-1 NAA/USPS-T31-1, 3 OCA/USPS-T31-2 VP/USPS-T31-3
American Postal Workers Union, AFL-CIO	APWU/USPS-T31-1-8 VP/USPS-T31-2-3
Association for Postal Commerce	APWU/USPS-T31-1, 3, 5 VP/USPS-T31-2, 4
Greeting Card Association	ABA-NAPM/USPS-T31-1 DFS & MSI/USPS-T31-1 GCA/USPS-T31-1 NAA/USPS-T31-1-7
Mailing & Fulfillment Service Association	APWU/USPS-T31-1, 3, 5 VP/USPS-T31-2, 4

PartyInterrogatories

Newspaper Association of America

ABA-NAPM/USPS-T31-1

GCA/USPS-T31-1

NAA/USPS-T31-1, 3-7

UPS/USPS-T31-1-2

Office of the Consumer Advocate

NAA/USPS-T31-8

VP/USPS-T31-5

Postal Rate Commission

ABA-NAPM/USPS-T31-1

APWU/USPS-T31-1-8

DFS & MSI/USPS-T31-1

NAA/USPS-T31-1-8

OCA/USPS-T31-1-3

PRC/USPS-POIR No.3 - Q4a, 4b, 4e, 4f, 4g
redirected to T31

UPS/USPS-T31-1-2

VP/USPS-T31-2-6

United Parcel Service

ABA-NAPM/USPS-T31-1

APWU/USPS-T31-1, 3, 7

DFS & MSI/USPS-T31-1

NAA/USPS-T31-3, 8

OCA/USPS-T31-1

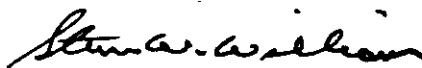
UPS/USPS-T31-1-2

VP/USPS-T31-5

Valpak Direct Marketing Systems,
Inc. and Valpak Dealers'
Association Inc.

VP/USPS-T31-2-6

Respectfully submitted,

Steven W. Williams
Secretary

INTERROGATORY RESPONSES OF
UNITED STATES POSTAL SERVICE
WITNESS DONALD J. O'HARA (T-31)
DESIGNATED AS WRITTEN CROSS-EXAMINATION

InterrogatoryDesignating Parties

ABA-NAPM/USPS-T31-1

ABA-NAPM, GCA, NAA,
PRC, UPS

APWU/USPS-T31-1

APWU, MFSA, PostCom,
PRC, UPS

APWU/USPS-T31-2

APWU, PRC

APWU/USPS-T31-3

APWU, MFSA, PostCom,
PRC, UPS

APWU/USPS-T31-4

APWU, PRC

APWU/USPS-T31-5

APWU, MFSA, PostCom,
PRC

APWU/USPS-T31-6

APWU, PRC

APWU/USPS-T31-7

APWU, PRC, UPS

APWU/USPS-T31-8

APWU, PRC

DFS & MSI/USPS-T31-1

GCA, PRC, UPS

GCA/USPS-T31-1

ABA-NAPM, GCA, NAA

NAA/USPS-T31-1

ABA-NAPM, GCA, NAA,
PRC

NAA/USPS-T31-2

GCA, PRC

NAA/USPS-T31-3

ABA-NAPM, GCA, NAA,
PRC, UPS

NAA/USPS-T31-4

GCA, NAA, PRC

NAA/USPS-T31-5

GCA, NAA, PRC

NAA/USPS-T31-6

GCA, NAA, PRC

NAA/USPS-T31-7

GCA, NAA, PRC

NAA/USPS-T31-8

OCA, PRC, UPS

OCA/USPS-T31-1

PRC, UPS

OCA/USPS-T31-2

ABA-NAPM, PRC

OCA/USPS-T31-3

PRC

PRC/USPS-POIR No.3 - Q4a redirected to T31

PRC

PRC/USPS-POIR No.3 - Q4b redirected to T31

PRC

PRC/USPS-POIR No.3 - Q4e redirected to T31

PRC

PRC/USPS-POIR No.3 - Q4f redirected to T31

PRC

PRC/USPS-POIR No.3 - Q4g redirected to T31

PRC

UPS/USPS-T31-1

NAA, PRC, UPS

Interrogatory

UPS/USPS-T31-2

VP/USPS-T31-2

VP/USPS-T31-3

VP/USPS-T31-4

VP/USPS-T31-5

VP/USPS-T31-6

Designating Parties

NAA, PRC, UPS

APWU, MFSA, PostCom,
PRC, ValpakABA-NAPM, APWU, PRC,
ValpakMFSA, PostCom, PRC,
Valpak

OCA, PRC, UPS, Valpak

PRC, Valpak

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA
TO INTERROGATORY OF AMERICAN BANKERS ASSOCIATION
AND NATIONAL ASSOCIATION OF PRESORT MAILERS
Revised: August 30, 2006**

ABA-NAPM/USPS T31-1

Attached is a table showing Cost Coverages for First Class Mail and Standard A Mail from 1994 on, including a comparison to the system-wide average. Please confirm that the figures in the attached table are correct. If you do not confirm, please provide the correct numbers.

RESPONSE

I believe that two modifications should be made to the data in your attachment.

1. Data for FY 2006, FY2007, and FY 2008 should be updated to incorporate revisions since the original filing. I have included the revised data on the first page of the attachment to my response, just below the original data for these years.
2. Beginning in FY 2000, the CRA provides Standard Mail costs only for Regular and Nonprofit combined and for ECR and NECR combined. In earlier years, costs were provided for each of the four subclasses. Your data for Standard Mail in 1999 (and presumably for 1994 – 1998 as well) are for the commercial portions of Regular and ECR. To get an apples-to-apples comparison of coverages before and after FY 2000, I would recommend aggregating data from the earlier years to the level of detail reported beginning in FY 2000. The second page of the attachment does this for 1999; if you accept my recommendation, data for FY 1994 through FY 1998 should be similarly aggregated.

**Recent Cost Coverages For First Class and Standard A Mail
Compared to System-Wide Average for All Mail & Special Services
Cost Coverage**

Year	System-Wide Average	First-Class Mail Letters			Standard Mail		
		Total	Single-Piece	Presort	Total	Regular	ECR
1994	155%	167%	150%	216%	148%	131%	217%
1995	163%	173%	151%	247%	157%	140%	227%
1996	164%	175%	150%	262%	159%	144%	230%
1997	181%	204%	182%	275%	166%	154%	242%
1998	179%	209%	186%	276%	161%	142%	248%
1999	168%	196%	175%	259%	149%	136%	207%
2000	171%	202%	174%	280%	156%	135%	220%
2001	171%	202%	173%	278%	157%	135%	233%
2002	173%	207%	176%	286%	157%	137%	224%
2003	186%	218%	181%	314%	175%	152%	263%
2004	185%	219%	180%	321%	174%	154%	245%
2005	176%	210%	172%	301%	172%	160%	204%
2006*	188%	227%	187%	332%	178%	160%	244%
2007	181%	217%	177%	309%	178%	168%	209%
TY2008	188%	226%	183%	317%	185%	177%	213%
FY2006BR	176%	214%	174%	303%	173%	162%	207%
FY2007BR	175%	215%	174%	301%	171%	161%	203%
TY2008AR	189%	229%	186%	312%	185%	177%	214%
	System-Wide Average	Compared to Average First-Class Mail Letters			Compared to Average Standard Mail		
		Total	Single-Piece	Presort	Total	Regular	ECR
1994	155%	1.08	0.97	1.39	0.95	0.85	1.40
1995	163%	1.06	0.93	1.52	0.96	0.86	1.39
1996	164%	1.07	0.91	1.60	0.97	0.88	1.40
1997	181%	1.13	1.01	1.52	0.92	0.85	1.34
1998	179%	1.17	1.04	1.54	0.90	0.79	1.39
1999	168%	1.17	1.04	1.54	0.89	0.81	1.23
2000	171%	1.18	1.02	1.64	0.91	0.79	1.29
2001	171%	1.18	1.01	1.63	0.92	0.79	1.36
2002	173%	1.20	1.02	1.65	0.91	0.79	1.29
2003	186%	1.17	0.97	1.69	0.94	0.82	1.41
2004	185%	1.18	0.97	1.74	0.94	0.83	1.32
2005	176%	1.19	0.98	1.71	0.98	0.91	1.16
2006*	188%	1.21	0.99	1.77	0.95	0.85	1.30
2007	181%	1.20	0.98	1.71	0.98	0.93	1.15
TY2008	188%	1.20	0.97	1.69	0.98	0.94	1.13
FY2006BR	176%	1.22	0.99	1.72	0.99	0.92	1.18
FY2007BR	175%	1.23	0.99	1.72	0.98	0.92	1.16
TY2008AR	189%	1.21	0.99	1.65	0.98	0.94	1.14

**Recent Cost Coverages For First Class and Standard A Mail
Compared to System-Wide Average for All Mail & Special Services
Cost Coverage**

Year	System- Wide Average	Standard Mail		
		Total	Regular	ECR
From interrogatory:		From interrogatory:		
1999	168%	149%	136%	207%
		From FY 1999 CRA:		
		149%	131%	201%
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**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA
TO INTERROGATORY OF AMERICAN POSTAL WORKERS UNION**

APWU/USPS-T31-1.

On page 4 of your testimony you make the statement "[i]n re-examining the relationship between costs and prices, it became clear that the current rate structures did not adequately reflect the greater costs of handling a flat or parcel as compared to a letter."

- a) What prompted the re-examination of these relationships?
- b) Weren't these relationships clear to the Postal Service five years ago when the previous realignment of rates was done?
- c) How was the decision reached to begin the deaveraging of costs as seen in this docket?
- d) Was it your decision to deaverage costs using shape and other factors as presented in this docket? If not, which witness(es) made those decisions?

RESPONSE:

- a) These relationships have been examined as part of the process of preparation for each omnibus rate-case since at least since Docket No. R97-1. For example, for single-piece First Class Mail, there have long been different first-ounce rates for letters versus nonletters (flats and parcels) and non-machinable letters.
- b) The relationships were clear but the Postal Service decided that changing the rate structure for flats and parcels in First-Class Mail and parcels in Standard Mail was not as high a priority as the proposed changes that were included in previous cases.
- c) This decision was reached through the usual process of preparing for an omnibus rate case. The existing rate design is reviewed, as well as the relevant subclass volume, cost, and revenue data. Specific proposals are developed which reflect this information in a manner that is consistent with the strategic goals of the Postal Service. The proposals are reviewed, and the process culminates with the approval by the Governors and the filing of the Request. As my response to part (a) suggests, the proposals in this

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA
TO INTERROGATORY OF AMERICAN POSTAL WORKERS UNION**

RESPONSE to APWU/USPS-T31-1 (continued):

case are not the "beginning" of shape-recognition (or de-averaging) but rather a *restructuring and extension of the way shape had previously been* incorporated in the rate structure.

- d) This decision was not made by any witness. Please see my response to part (c).

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA
TO INTERROGATORY OF AMERICAN POSTAL WORKERS UNION**

APWU/USPS-T31-2.

Does deaveraging costs and increasing the number of rates in the schedules tend to make it more difficult for users to determine the correct postage for a given mail piece?

RESPONSE:

Depending on how it is done, increasing the number of rates in the schedules for single-piece mailers can make it more difficult for them to determine the correct postage, and this aspect of the *proposed rate-structure change for First-Class Mail* was considered as part of the decision process.

The transition to the new structure will require mailers to learn how to determine where a given piece falls with respect to the letter/flat/parcel lines, but once the new structure has been in place for a while, I do not think it will be much more difficult for single-piece mailers to determine the correct postage than it is under the current structure.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA
TO INTERROGATORY OF AMERICAN POSTAL WORKERS UNION**

APWU/USPS-T31-3.

On page 20 of your testimony you make the following statement about the First Class cards subclass "[t]he proposed rate level reflects a balanced consideration of all the relevant criteria: it is fair and equitable (criterion 1)." On page 19 of your testimony you make the statement about the First Class letters subclass that the "proposed rate level is fair and equitable (criterion 1); it reflects a careful consideration of the §3622(b) criteria." These statements seem to imply that it is your understanding that the first criterion of §3622(b) is determined by how well the other eight criterion in the section are followed. Is that a correct understanding of these statements?

RESPONSE:

Not correct. I do think Criterion 1 has a somewhat different role than the other criteria. I view it as an instruction to consider, from the broad perspective of fairness and equity, the result that has been reached by considering the other criteria individually. If such consideration gives rise to fairness and equity concerns, the balance among the other criteria may need to be re-examined, and/or some factor not explicitly mentioned in the other criteria is important enough that it should have been considered under criterion 9.

In my view, the "overall evaluation" role of criterion 1 stems from its broad and inclusive nature. In fact, I do not see how it could be usefully applied without having already considered the subject matter of the other criteria.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA
TO INTERROGATORY OF AMERICAN POSTAL WORKERS UNION**

APWU/USPS-T31-4.

In your testimony, you discuss the nine criteria listed in section 3622(b) of the Postal Reorganization Act (PRA). You will observe that the first paragraph of section 3622(b) requires that the Commission make a recommended decision "in accordance with the policies of this title and the following factors:"

- a) Is it the position of the Postal Service that the phrase "in accordance with the policies of this title" adds nothing to the requirement that the recommendation be in accordance with the nine listed factors?
- b) If your answer to a above is yes, why did Congress refer to the "policies of this title" in 3622(b) instead of just referring to the nine factors?
- c) Does your testimony make reference to any policy of the PRA other than those stated in the nine factors listed in 3622(b)?
- d) If your answer to c above is yes, point out the place or places in your testimony where that reference(s) is made, point out where in the Act the policy in question is stated, and explain how your reference weighs the policy in question.
- e) In your testimony, did you make any reference to the requirements of section 3622(a) of the PRA that the Postal Service's requested rate changes must "be ... in accordance with the policies of this title"?
- f) If your answer to e above is yes, point out the place or places in your testimony where that reference(s) is made.
- g) If your testimony makes reference to the requirement of section 3622(a) that the Postal Service request be "in accordance with the policies of this title," does it make reference to any specific policy of the PRA that is not one of the nine factors listed in 3622(b)?
- h) If your answer to g above is yes, point out the place or places in your testimony where that reference(s) is made point out where in the Act the policy in question is stated, and explain how your reference weighs the policy in question.

RESPONSE:

- a) No.
- b) Not applicable.
- c) Yes.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA
TO INTERROGATORY OF AMERICAN POSTAL WORKERS UNION**

RESPONSE to APWU/USPS-T31-4(continued):

- d) Please see my discussion of § 3626 (*rates for preferred subclasses*) at page 15, line through page 16, line 16. The *policies in this section* are stated in terms of *specific numerical relationships*; they are required to be met "as nearly as practicable," not weighed relative to other policies in the Act. I would also note that policies in § 3623 (*classification criteria*) are discussed by the pricing witnesses.
- e) Not explicitly.
- f) Not applicable.
- g) Please see my response to subpart (d).
- h) Please see my response to subpart (d).

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA
TO INTERROGATORY OF AMERICAN POSTAL WORKERS UNION**

APWU/USPS-T31-5.

Section 101(a) of the PRA states, in part:

"The Postal Service shall have as its basic function the obligation to provide postal services to bind the Nation together through the personal, educational, literary, and business correspondence of the people."

- a) Do you agree that this provision of the PRA states a policy of Title 39 of the United States Code within the meaning of section 3622(a) of the Act?
- b) If your answer to a above is yes, does your testimony discuss or consider this policy?
- c) If your answer to b above is yes, point to the statement or statements in your testimony that discuss or consider this policy.

RESPONSE:

- a) While I am not an attorney, I do understand the quoted sentence to be a policy of the Postal Service and the Postal Reorganization Act.
However, the question of whether any one of the numerous policies of the Act outside of chapter 36 is relevant to postal ratemaking requires a legal conclusion that I am not qualified to make.
- b) My testimony does not discuss this policy, but I believe that it is directly reflected in criterion 8 (ECSI value) of § 3622(b). For Periodicals, in addition to the substantial recognition of ECSI value in determining its cost-coverage relative to other subclasses, the rate structure explicitly treats editorial matter more favorably than advertising.
- c) Not applicable.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA
TO INTERROGATORY OF AMERICAN POSTAL WORKERS UNION**

APWU/USPS-T31-6.

Section 101(a) of the PRA states, in part:

"The Postal Service...shall provide prompt, reliable, and efficient services to patrons in all areas and shall render postal services to all communities."

- a) Do you agree that this provision of the PRA states a policy of Title 39 of the *United States Code* within the meaning of section 3622(a) of the Act?
- b) If your answer to a above is yes, does your testimony discuss or consider this policy?
- c) If your answer to b above is yes, point to the statement or statements in your testimony that discuss or consider this policy.

RESPONSE:

- a) While I am not an attorney, I do understand the quoted sentence to be a policy of the Postal Service and the Postal Reorganization Act.
However, the question of whether any one of the numerous policies of the Act outside of chapter 36 is relevant to postal ratemaking requires a legal conclusion that I am not qualified to make.
- b) Not applicable.
- c) Not applicable.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA
TO INTERROGATORY OF AMERICAN POSTAL WORKERS UNION**

APWU/USPS-T31-7.

Section 101(a) of the PRA states, in part:

"The costs of establishing and maintaining the Postal Service shall not be apportioned to impair the overall value of such service to the people."

a) What is your understanding of the term "the people" in the passage of the Act quoted above?

b) On pages 3-4 of your testimony, you state:

"[I]n this case as in previous cases, the Postal Service's overall objective has been to craft a price and classification proposal that not only addresses concerns about the relationships between cost drivers and prices but that also provides its customers with an increased number of choices allowing them to elect the postal products and services that have the most value in meeting their business needs."

Does the Postal Service's "overall objective" take into consideration the value of postal services to all "the people" or only to business people?

c) If your answer to b above is that the Postal Service's overall objective takes the value of postal services to all the people into consideration, where in your testimony is there any discussion of the value of postal services to people who are not in business?

RESPONSE:

a) The entire population of the United States, acting in their various capacities as users and beneficiaries of the postal system.

b) The Postal Service takes into consideration the diverse needs of all the people, both directly as users of postal services to transmit correspondence, payments, and packages, and indirectly through their purchases of products and services produced by businesses and other organizations that they operate which businesses and organizations that use postal services to a greater or lesser degree.

My use of the word "overall" in the quoted paragraph appears to have generated some misunderstanding. It would have been better to say

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA
TO INTERROGATORY OF AMERICAN POSTAL WORKERS UNION**

RESPONSE to APWU/USPS-T31-7 (continued):

that one of the Postal Service's broad objectives for business customers is increased choices.

One example is splitting the 3/5 presort rate for Standard Mail flats into separate 3-digit and 5-digit rates, and letting the customer choose whether to presort to none, some, or all the 5-digit areas in a given mailing. Under the current 3/5 rate structure, 5-digit sortation is required.

- c) My testimony does not explicitly discuss the "value of postal services to people who are not in business." Value of service is an attribute of the particular postal service in question and does not depend on whether the service is being used for personal or business purposes.

For example, the Forever Stamp proposed in this case will be available for single-piece First-Class Mail sent for either personal or business purposes. Nonetheless, I believe it will be of greatest value (in terms of convenience) for mail that people send in their non-business roles. I think this is also the case for the experimental Premium Forwarding Service.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA
TO INTERROGATORY OF AMERICAN POSTAL WORKERS UNION**

APWU/USPS-T31-8.

Section 101(a) of the PRA states, in part:

"The Postal Service shall provide a maximum degree of effective and regular postal services to rural areas, communities and small towns where Post offices are not self-sustaining. No small post office shall be closed solely for operating at a deficit, it being the specific intent of the Congress that effective postal services be insured to residents of both urban and rural communities."

- a) Do you agree that this provision of the PRA states a policy of Title 39 of the United States Code within the meaning of section 3622(a) of the Act?
- b) If your answer to a above is yes, does your testimony discuss or consider this policy?
- c) If your answer to b above is yes, point to the statement or statements in your testimony that discuss or consider this policy.

RESPONSE:

- a) While I am not an attorney, I do understand the quoted sentence to be a policy of the Postal Service and the Postal Reorganization Act.
However, the question of whether any one of the numerous policies of the Act outside of chapter 36 is relevant to postal ratemaking requires a legal conclusion that I am not qualified to make.
- b) Not applicable.
- c) Not applicable.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA TO
INTERROGATORY OF
DISCOVER FINANCIAL SERVICES & MORGAN STANLEY**

DFS & MSI-T31-1

Please refer to page 13 and 14 of your testimony where you discuss "Degree of Preparation."

- a. Please confirm that work-shared mail tends to be more cost efficient for the Postal Service to handle than non-work-shared mail.
- b. Please confirm that as the degree of worksharing in a class or subclass increases over time, the cost coverage for that class must be increased if the Postal Service is to maintain the same institutional contribution of that class or subclass.
- c. Please confirm that the consequence of the dynamic discussed in part (b) of this interrogatory is that the cost coverage of a subclass with a greater-than-average increase in worksharing will need to increase relative to the system-average coverage if and only if the Postal Service wishes to maintain the institutional cost contribution of that subclass.
- d. Please confirm that the net effect of the dynamics discussed in parts (b) and part (c) of this interrogatory is to, over time, increase the *relative* institutional cost burden of work-shared mail more than that of non-workshared mail.
- e. Please confirm that the net effect of the dynamics mentioned in parts (b) through (d) of this interrogatory is that the more efficient mail becomes, the greater its relative institutional cost burden becomes.
- f. Would not economic efficiencies tend to be more strongly encouraged if the relative burden of work-shared mail did not increase as that mail becomes more efficient?

RESPONSE:

I think the discussion below will be easier to follow if the following simplifying assumptions are used: (1) the *only* things that change are the proportion of workshared mail in a subclass and, as a result, the *total* volume-variable cost of that subclass. However, (2) volume-variable cost *per piece* for is fixed for each level of worksharing within a subclass, (3) mail volume in each subclass is fixed, and (4) total institution cost is fixed.

- a. Not confirmed as stated because the term "cost efficient," as I understand it, does not fit the context in which you use it. I can confirm that workshared mail costs the Postal Service less per piece to collect,

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA TO
INTERROGATORY OF
DISCOVER FINANCIAL SERVICES & MORGAN STANLEY**

RESPONSE to DFS&MSI/USPS-T32-1 (continued):

- process, and deliver than non-workshared mail (of similar shape, weight, service standard, etc.).
- b. Confirmed. If the cost coverage is not increased to a level that achieves *the same contribution per piece* as before, some of the institutional cost burden will have to be shifted to other subclasses. In a sense, increasing the cost coverage of a subclass by a particular amount is the result of a decision to retain the previous distribution of *the institutional cost burden* across subclasses, not a policy objective in itself.
- c. I confirm the "if" portion of statement, but do not confirm the "only if" portion, at least as a general statement. "Only if" would seem to deny the possibility of any other reason to raise a subclass's cost coverage relative to the system average.
- d. Not confirmed. In this case, changes in cost-coverage are not a good indicator of shifts in relative institutional cost burden. The subclass with an above-average increase in worksharing (and an appropriate increase in cost-coverage) will nevertheless be paying the same amount toward institutional cost as before, *both per piece and for the subclass a whole*.
- e. Not confirmed, for the reason stated in my response to part (d).
- f. Not applicable. A subclass's institutional cost burden does not increase unless and until its cost coverage is increased *beyond* the level needed to retain the same per piece contribution to institutional cost as worksharing increases.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA TO
INTERROGATORY OF
DISCOVER FINANCIAL SERVICES & MORGAN STANLEY**

RESPONSE to DFS&MSI/USPS-T32-1 (continued):

On the other hand, a policy that retained the preexisting percentage cost coverages as worksharing increased would actually reduce the subclass's *institutional cost burden*, forcing an increased burden on other subclasses. To translate from the above set of simplifying assumptions to real world situations where items (2) through (4) do change, the "no change in contribution per piece" benchmark for retaining the pre-existing distribution of the institutional cost burden across subclasses should be replaced by "no change in contribution per piece as a *percentage total institutional cost*."

My point is not that the distribution of the institutional cost burden should never change; it is only that, in many situations, unchanged cost coverages are not the right starting point for evaluating shifts of the institutional cost burden. A better starting point is a set of coverages obtained by modifying pre-existing cost coverages as needed to achieve the pre-existing contributions per piece (or pre-existing contribution per piece as a *percentage total institutional cost*"). These adjusted coverages can then be raised or lowered as necessary for total contribution to equal institutional cost, and then modified individually as warranted by the nine pricing criteria.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA
TO INTERROGATORY OF THE GREETING CARD ASSOCIATION**

GCA-T31-1 USPS witness Taufique remarks that a goal of rate design in First Class is "obtaining similar unit contributions for Single-Piece Letters in the aggregate and from Presort Letters in the aggregate". (USPS-T-32, page 15, lines 20-21.) Please refer to the attached Excel spread sheet, which lists certain financials derived from your testimony and others from R2006-1 and the same information from the last litigated rate case, in R2000-1.

- a. Please confirm that the per unit contribution toward USPS institutional costs proposed in this case is only 10 cents for Standard A Regular commercial and non-profit mail while it is 23.5 cents for *First Class Single Piece mail*, a gap of 13.5 cents.
- b. Please confirm that the per unit contribution toward USPS institutional costs proposed in R2000-1 was only 5.5 cents for Standard A Regular commercial and non-profit mail while it was 18.1 cents for *First Class Single Piece mail*.
- c. Please confirm that measured in cents, the gap in per unit contributions to institutional costs is growing between First Class Mail and Standard A Regular mail, from a 12.7 cent difference in R2000-1 to a 13.5 cent difference in R2006-1.

RESPONSE:

As a preliminary matter, please note that witness Taufique's testimony deals only with First-Class Mail. Your interrogatory compares unit contributions for mail in two different subclasses, and obtaining similar unit contributions across subclasses is not a goal of the Postal Service in this case.

- a. Confirmed that the Docket No. R2006-1 (as-filed) proposed unit contribution toward institutional costs is 10.0 cents for Standard Mail Regular and 23.5 cents for single piece First-Class Mail, a difference of 13.5 cents. After revisions, the corresponding numbers are 10.0 cents, 24.2 cents, and 14.2 cents. Two versions of your attachment are appended to this response -- one using Docket No. R2006-1 as-filed data (your original), and the second using revised data.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA
TO INTERROGATORY OF THE GREETING CARD ASSOCIATION**

RESPONSE to GCA/USPS-T31-1 (continued):

- b. Confirmed that the R2000-1 proposed unit contribution toward institutional costs was 8.5 cents for Standard Mail Regular and 18.1 cents for single piece First-Class Mail.

- c. Confirmed that the difference in proposed unit contributions between single-piece First-Class Mail and Standard Mail Regular was 12.7 cents in Docket No. R2000-1; and, in Docket No. R2006-1, 13.5 cents (as filed), becoming 14.2 cents after revisions.

R2006-1 (As Filed)

First-Class Mail
Financials for Single-Piece and Presort Letters

Test Year After Rates Financials		
	Single Piece	Presort
Total Revenue	\$ 19,124,695	\$ 16,673,609
Volume	37,056,128	48,693,069
Revenue per Piece	\$ 0.516	\$ 0.342
Rollforward Cost	\$ 10,424,565	\$ 5,263,369
Cost per Unit	\$ 0.281	\$ 0.108
Per Unit Contribution	\$ 0.235	\$ 0.234
Implicit Cost Coverage	183.5%	316.8%

Standard Mail
Financials for Standard Mail Regular

Test Year After Rates Financials			
	Commercial	Nonprofit	Total Regular
Total Revenue	\$ 15,521,094	\$ 1,843,033	\$ 17,364,127
Volume	62,815,558	12,372,554	75,188,112
Revenue per Piece	\$ 0.247	\$ 0.149	\$ 0.231
Rollforward Cost			\$ 9,835,815
Cost per Unit			\$ 0.131
Per Unit Contribution			\$ 0.100
Implicit Cost Coverage			176.5%

First-Class Mail
Financials for Single-Piece and Presort Letters

Test Year After Rates Financials	
	Single Piece
Total Revenue	\$ 19,430,640
Volume	37,206,438
Revenue per Piece	\$ 0.522
Rollforward Cost	\$ 10,423,261
Cost per Unit	\$ 0.280
Per Unit Contribution	\$ 0.242
Implicit Cost Coverage	186.4%

FCM data are obtained from R2006-1, USPS-LR-L-129, WP-FCM-12.

STD mail volumes and revenues are obtained from R2006-1, USPS-T-36, WP-STDREG-30 through 32.

Rollforward costs are obtained from R2006-1, USPS-T-10, FY 2008 After Rates D Report, Exhibit USPS-10M.

FCM data are obtained from R2006-1, USPS-LR-L-129, WP-FCM-12.

STD mail volumes and revenues are obtained from R2006-1, USPS-T-36, WP-STDREG-30 through 32.

Rollforward costs are obtained from R2006-1, USPS-T-10, FY 2008 After Rates D Report, Exhibit USPS-10M.

R2000-1

First-Class Mail
Financials for Single-Piece and Presort Letters

Test Year After Rates Financials		
	Single Piece	Presort
Postage Revenue	\$ 22,746,522	\$ 13,229,830
Total Revenue	\$ 22,913,594	\$ 13,252,350
Volume	52,877,658	46,979,736
Revenue per Piece	\$ 0.433	\$ 0.282
Rollforward Cost	\$ 13,326,042	\$ 5,019,464
Cost per Unit	\$ 0.252	\$ 0.107
Per Unit Contribution	\$ 0.181	\$ 0.175
Implicit Cost Coverage	171.9%	264.0%

Standard Mail
Financials for Standard Mail Regular

Test Year After Rates Financials			
	Commercial	Nonprofit	Total Regular
Postage Revenue			
Total Revenue			\$ 9,070,437
Volume			40,998,656
Revenue per Piece			\$ 0.221
Rollforward Cost			\$ 6,823,933
Cost per Unit			\$ 0.166
Per Unit Contribution			\$ 0.055
Implicit Cost Coverage			132.9%

First-Class Mail
Financials for Single-Piece and Presort Letters

Test Year After Rates Financials	
	Single Piece
Postage Revenue	\$ 22,746,522
Total Revenue	\$ 22,913,594
Volume	52,877,658
Revenue per Piece	\$ 0.433
Rollforward Cost	\$ 13,326,042
Cost per Unit	\$ 0.252
Per Unit Contribution	\$ 0.181
Implicit Cost Coverage	171.9%

FCM revenue, cost, and volume are obtained from R2000-1, USPS-T-33, Workpaper, page 2, revised 4/17/00.

STD mail revenue, cost, and volume are obtained from R2000-1, USPS-LR-L-166, WP1, pages 21 & 25.

FCM revenue, cost, and volume are obtained from R2000-1, USPS-T-33, Workpaper, page 2, revised 4/17/00.

STD mail revenue, cost, and volume are obtained from R2000-1, USPS-LR-L-166, WP1, pages 21 & 25.

R2006-1 (Revised)

Standard Mail
Financials for Standard Mail Regular

Test Year After Rates Financials					Difference SP - STD
Presort	Commercial	Nonprofit	Total Regular		
\$ 16,440,420	Total Revenue \$ 15,521,094	\$ 1,843,032	\$ 17,364,127		
48,542,760	Volume 62,815,558	12,372,554	75,188,113		
\$ 0.339	Revenue per Piece \$ 0.247	\$ 0.149	\$ 0.231		\$ 0.291
\$ 5,265,124	Rollforward Cost		\$ 9,836,572		
\$ 0.108	Cost per Unit		\$ 0.131		\$ 0.149
\$ 0.230	Per Unit Contribution		\$ 0.100		\$ 0.142
312.3%	Implicit Cost Coverage		176.5%		9.9%

SPS-LR-I-129, WP-FCM-12 Revised

derived from R2006-1, USPS-T-36, WP-STDREG-30 through 32.

R2006-1, USPS-T-10, FY 2008 After Rates D Report, Exhibit USPS-10M Revised

R2000-1

Standard Mail
Financials for Standard Mail Regular

Test Year After Rates Financials					Difference SP - STD
Presort	Commercial	Nonprofit	Total Regular		
\$ 13,229,830	Postage Revenue				
\$ 13,252,350	Total Revenue		\$ 9,070,437		
46,979,736	Volume		40,998,656		
\$ 0.282	Revenue per Piece		\$ 0.221		\$ 0.212
\$ 5,019,464	Rollforward Cost		\$ 6,823,933		
\$ 0.107	Cost per Unit		\$ 0.166		\$ 0.086
\$ 0.175	Per Unit Contribution		\$ 0.055		\$ 0.127
264.0%	Implicit Cost Coverage		132.9%		39.0%

derived from R2000-1, USPS-T-33, Workpaper, page 2, revised 4/17/00.

obtained from R2000-1, USPS-LR-I-166, WP1, pages 21 & 25.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA
TO INTERROGATORY OF NEWSPAPER ASSOCIATION OF AMERICA**

NAA/USPS-T31-1.

Please refer to page 30, lines 15-17, of your testimony where you compare the unit contributions at proposed rates for Standard Regular and Enhanced Carrier Route mail.

- a. Please provide citations to the inputs that you used in making those calculations.
- b. Using the same methodology as in (a), please provide the contribution per piece at proposed rates of:
 - i. First Class letters subclass
 - ii. First Class single piece letters
 - iii. First Class presorted letters
 - iv. First Class cards subclass
 - v. Periodicals Outside County Regular Rate
 - vi. Periodicals In-County

RESPONSE:

- a. Revenue and volume-variable cost for each subclass are in my revised Exhibit 31B and the corresponding volumes in the TY08 AR workpapers, both to be filed.
- b. Cost data for the three Outside County subclasses are no longer reported individually, only the cost for all Outside County mail as an aggregate, so I have substitute the Outside County aggregate for the requested Outside County Regular Rate in the table below, based on the revised data.

	Volume	Revenue	Volume- Variable Cost	Unit Contri- bution
i. First Class letters subclass	85,749,198	35,871,060	15,688,385	0.2354
ii. First Class single piece letters	37,206,438	19,430,640	10,423,261	0.2421
iii. First Class presorted letters	48,542,760	16,440,420	5,265,124	0.2302
iv. First Class cards subclass	5,657,451	1,371,777	777,270	0.1051
v. Periodicals Outside County Total	8,049,954	2,394,326	2,250,111	0.0179
vi. Periodicals In-County	700,140	82,354	79,517	0.0041
vii. Standard Regular	75,188,113	17,364,127	9,836,572	0.1001
viii. Standard Enhanced Carrier Route	31,864,791	5,956,641	2,780,943	0.0997

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA
TO INTERROGATORY OF NEWSPAPER ASSOCIATION OF AMERICA**

NAA/USPS-T31-2.

Table B-1 of your testimony presents the long-run own-price elasticities for various classes of mail estimated by witness Thress. You state on page 10 that the lower the absolute value of a type of mail, the greater its value of service. In view of the testimony of witness Bernstein on the subject of diversion of First-Class Mail to electronic alternatives, do you believe that First-Class Mail truly has a higher value of service than any other type of mail in Table B-1? Why?

RESPONSE:

Own-price elasticity has long been used to assess the economic value of service for each subclass relative to other subclasses. This elasticity measures the degree to which the demand for a product changes when its price changes, *holding constant everything else that affects demand for the product*, including the availability of electronic alternatives. Since econometricians can't actually hold "other things" constant at their initial levels, standard practice is to include in the estimated demand function a set of variables related to the relevant other things.

By doing this, the effect of own-price changes on demand for a subclass can be separated, at least approximately, from the effects of changes in other things such as the availability of electronic alternatives. When changes in other things have been controlled for in this way, I would not expect any particular change in economic value of service (i.e., own-price elasticity) as the availability of electronic alternatives has expanded.

As an aside, note that the estimated own-price elasticity of Within-County Periodicals falls between the elasticities for Presorted and Single-Piece First-Class Mail, indicating a similarly high economic value of service.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA
TO INTERROGATORY OF NEWSPAPER ASSOCIATION OF AMERICA**

NAA/USPS-T31-3.

For many years, First-Class Mail has both been a majority of the mailstream and has paid a majority of institutional costs. First-Class Mail is no longer a majority of the mailstream. Should First-Class Mail's relative decline as a share of the mailstream lead to a reduction in its institutional cost burden? Why or why not?

RESPONSE:

Not necessarily. Holding everything else constant (volume for all other subclasses, institutional cost, unit volume-variable cost, and cost-coverages), a reduction in First-Class Mail volume will reduce total contribution to an amount that is below the unchanged institutional cost.

To restore total contribution to its previous level, the average cost-coverage across all subclasses must be increased, and all nine pricing criteria must be considered in arriving at a new set of subclass coverages that together generate a total contribution equal to institutional cost. No general conclusion can be reached as to the direction and size of the resulting change in contribution from First-Class Mail.

It is quite possible for a reduction in both the absolute amount of First-Class Mail's contribution and its share of total contribution to be accompanied by an increase in its cost coverage and unit contribution.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA
TO INTERROGATORY OF NEWSPAPER ASSOCIATION OF AMERICA**

NAA/USPS-T31-4.

Please refer to page 29, lines 19-22 of your testimony. Did you review any information regarding the number and size of alternate delivery firms in preparing your testimony? If so, please describe what information you reviewed.

RESPONSE:

I did not. The Postal Service evaluates its rate proposals for their effect on "enterprises in the private sector of the economy engaged in the delivery of mail matter other than letters" (Criterion 4) by comparing its proposed increases for products for which there are private sector enterprises delivering similar "mail matter" with the proposed increases for other products. Please see witness Kiefer's response to AAPS/USPS-T36-2, -6, & -8 for a detailed discussion of the Postal Service's proposed rate increases that are mostly likely to affect alternate delivery firms.

I believe that it would be very difficult, at best, for the Postal Service to acquire detailed information on the cost and demand structure faced by the alternative delivery industry sufficient to assess the causes of any recent changes in the number and size of alternate delivery firms. Any attempt to go beyond this and predict how much the number and size of alternative delivery firms in future years would be affected by the proposed rate increases seems to me unlikely to generate results that would be useful in a proceeding such as this.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA
TO INTERROGATORY OF NEWSPAPER ASSOCIATION OF AMERICA**

NAA/USPS-T31-5.

Please refer to page 29, lines 19-22 of your testimony. Is it your understanding that newspaper Total Market Coverage programs typically use Standard Enhanced Carrier Route mail (high-density or saturation levels as appropriate) to deliver preprints to nonsubscribers of the newspaper?

RESPONSE:

I understand that some newspapers have long used the Postal Service for this purpose and I further understand that in recent years the proportion of non-subscriber TMC volume that is delivered by the Postal Service has increased to the point that the word "typically" may now appropriate.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA
TO INTERROGATORY OF NEWSPAPER ASSOCIATION OF AMERICA**

NAA/USPS-T31-6.

Please refer to page 29, lines 1-6 of your testimony. Are you aware of any information held by the Postal Service regarding how often it "is able to accommodate mailer requests for delivery within specific and sometimes relatively tight time frames"? If so, please provide such information. If not, please explain the basis for the quoted statement.

RESPONSE:

I am not aware of any such information held by the Postal Service. My statement is based on discussions over a period of years with mailers and with Postal Service personnel involved in customer service and operations.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA
TO INTERROGATORY OF NEWSPAPER ASSOCIATION OF AMERICA**

NAA/USPS-T31-7.

Please refer to page 29, lines 4-6 of your testimony. Is it your understanding that for the Postal Service to accommodate mailer requests for delivery within particular time frames for high-density and saturation mailings, the mailers must use destination entry? If so, please explain whether the Postal Service is able to achieve the same accommodations if the mailings are entered at the destination SCF than if entered at the destination DDU.

RESPONSE:

No level of destination entry is required. Of course, the further away from the DDU that mail is deposited, the earlier it must be entered relative to the desired time frame for its delivery. It is my understanding that mailers with strong preferences for delivery within a specified time frame typically know how far in advance their mail should be deposited at a particular entry point in order for it to be delivered within the requested time frame.

As for differences between DSCF and DDU entry, it is my understanding that requested delivery time frames are met with roughly the same consistency, as long as DSCF mail is deposited with adequate lead time. However, many saturation and high-density mailers choose DDU entry because (a) they can use what would have been "lead-time" to reduce the gap between the deadline for customer purchase of advertising in "this week's" mailing and the time of its delivery, and (b) DDU entry gives them direct control over when their mail arrives at the DU.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA
TO INTERROGATORY OF NEWSPAPER ASSOCIATION OF AMERICA**

NAA/USPS-T31-8.

Please refer to page 8, lines 8-10, of your testimony where you recite the second statutory ratemaking criterion, and provide, for each subclass of mail, the performance record of the Postal Service in the Base Year compared to the service standard for that subclass of mail. If no service standard or performance record exists for a particular subclass, please so indicate.

RESPONSE:

Express Mail: Please see the response to OCA/USPS-T34-1.

Priority Mail: Please see the response to OCA/USPS-3.

First-Class Mail (Single-piece, combined subclasses): Please see the attached page 74 of the 2005 Comprehensive Statement on Postal Operations. Additional information, derived from RPW-ODIS data, is contained in the response to OCA/USPS-34, including a table for metered First-Class Mail Presort.

Periodicals: There is no service performance measure for Periodicals; service standards are on page 37 of Attachment G to Request, Docket No. R2006-1.

Standard Mail: There is no service performance measure for Standard Mail; service standards are on page 37 of Attachment G to Request, Docket No. R2006-1.

Package Services (Retail only): Please see the response to OCA/USPS-54. For each of the four Package Services subclasses, information on Days to Delivery [not tied to service commitment] is contained in the response OCA/USPS-30.

Chapter 4
2005 Performance Report and Preliminary
2007 Annual Performance Plan

2007 Preliminary	2001 Actual	2002 Actual	2003 Actual	2004 Actual	2005 Actual	2005 Target	2006 Target		
	94	94	95	95	95	95	95	Based on 2006	Based on 2006
First-Class Mail Overnight	85	85	90	91	91	91	91	92	90
First-Class Mail 2-Day	81	80	88	89	87	87	87	90	90
First-Class Mail 3-Day	Based on 2006								

Source: U.S. Postal Service External Measurement System (EXFEC). EXFEC is a statistically reliable system conducted by a firm under contract with the Postal Service, and is designed to cover the ZIP Codes that generate and receive the most mail. It is validated by comparative analysis with the Postal Service's internal Origin-Destination Information System, EXFEC performance results also generally correspond to results from the separate externally conducted Customer Satisfaction Measurement (CSM) survey. More detail is provided in chapter 2, section B.

Notes: Service performance scores are rounded for the full year, which is consistent with current Postal Service reporting conventions. Some previous reports did not round data. More detailed data, subject to seasonal exclusionary periods to reflect expected weather conditions and reduced airtail capacity (generally from late November to early February), are used internally. The table above corrects previous reports which mistakenly reported internal data for some previous years.

Before 2003, First-Class Mail 2-day and 3-day performance scores were combined and reported as a single score. Since 2003 the Postal Service has maintained separate 2-day and 3-day scores to better identify and address specific service issues. For consistency, the 2001 and 2002 results have been retroactively adjusted to show to separate 2-day and 3-day scores.

This report also adjusts previous scores that were based on the use of preliminary or unadjusted data due to the publication timing requirements of some previous reports. This integrated Comprehensive Statement/Performance Report eliminates such differences between documents.

Although performance results for Express Mail and Priority Mail have not been reported publicly, both have performance measurement systems and internal performance improvement targets. Express Mail is measured by the Product Tracking System (PTS), an internal measure of performance from acceptance at retail to delivery to a mailbox. All Express Mail is scanned at acceptance and delivery and all domestic ZIP Codes are included. The system is validated by the Express Mail Validation System, an external system that provides side-by-side comparisons of test piece results with PTS results.

Through 2005, Priority Mail has been measured by the Priority Mail End-to-End (PTE) system. However, in 2006 Priority Mail measurement will transition from PTE to the Delivery Confirmation Priority Mail-Retail (DCPM-R), a scanning system similar to that described above for Express Mail. PTE will be modified and used as an external validation system, similar to the system used for Express Mail. The changes will reduce costs, improve operational consistency, and increase sample size. PTE reported results primarily for flat-shaped Priority Mail. DCPM-R will expand coverage to other Priority Mail shapes.

As Postal Service delivery performance levels stabilize at historically high levels, the objective will be to maintain that level of service nationwide and to improve performance incrementally, where possible, at the local level. The Postal Service continues to investigate cost-effective performance measurement systems for other mail categories using existing barcode technology to enable passive scanning for all mail shapes.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA
TO INTERROGAOTRY OF THE OFFICE OF THE CONSUMER ADVOCATE**

OCA/USPS-T31-1.

Please confirm that nowhere in your testimony do you discuss the degree to which the Postal Service satisfies the service standards it has established for:

- a. Express Mail
- b. Priority Mail
- c. First Class
- d. Package Services

If you do not confirm this for a., b., c., or d., then provide a citation to your testimony where this is discussed.

RESPONSE:

Confirmed that I do not explicitly discuss service performance in my testimony.

However, Criterion 2 mentions both "mode of transportation" and "priority of delivery," as components of what is generally referred to as a product's "intrinsic" value of service.

Both could have a significant effect on service performance (although I understand that changes in the airline industry can create situations where a switch to ground transportation can provide the same average level of service performance with greater consistency.)

As part of my job, I need to be knowledgeable about both the applicable service standards for various products and the available data regarding the Postal Service's experiences in meeting these standards, and my decisions in establishing cost coverages were informed by this knowledge.

In this case, the Postal Service is not proposing any cost-coverage adjustments based on changes in service performance, but I would note that the improved performance of single-piece First-Class Mail with two- and three-day service commitments is one of the more notable service-performance developments during the past five years.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA
TO INTERROGAOTRY OF THE OFFICE OF THE CONSUMER ADVOCATE**

OCA/USPS-T31-2.

Consider the following hypothetical. The Postal Service establishes a 4-day service standard for a particular product. Do you agree that the value of service is higher if the 4-day standard is met 100% of the time, as opposed to 80% of the time? If you do not agree, then please explain.

RESPONSE:

Yes.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA
TO INTERROGAOTRY OF THE OFFICE OF THE CONSUMER ADVOCATE**

OCA/USPS-T31-3.

Consider the following hypothetical. The Postal Service establishes 2 new products – A has a 4-day service standard; the other, B, has a 2-day service standard. A's 4-day service standard is met 100% of the time. B's 2-day service standard is met only 30% of the time and, in fact, delays are so severe that the average delivery time for B is actually 5 days. Holding all other factors equal, does A or B have a higher value of service? Please explain your answer.

RESPONSE:

The service performance against standard for Product B in this hypothetical represents such an extreme case that I doubt that it would ever arise, and, if it did, I would expect the Postal Service to focus on improving the product's service performance

It might seem obvious that a product with an average delivery time of four days would have a higher value of service than one with an average delivery time of five days. However, average delivery time is not the only aspect of service performance that matters to customers. Variation around the average can also be important.

The only information on variation in your example is that Product B meets its two-day service standard 30% of the time. If, hypothetically speaking, Product A were never delivered sooner than the third day, it is conceivable that customers on average could prefer Product B's 30% chance of delivery in two days to the certainty the Product A will never be delivered in two days but will always be delivered in four days.

Geographic variation in service performance may also be important. For Product A, suppose that days-to-delivery were tightly clustered around the four-day standard across all origin-destination (OD) pairs. For Product B, suppose that the 30% of pieces delivered in two days were not randomly distributed across all OD pairs but were concentrated in a subset of pairs (e.g., pairs connecting two major metropolitan areas or pairs that are only a short distance apart), and customers were aware of this. Conceivably customers could then value Product B's service performance more than that of Product A.

4. Please refer to both USPS-LR-L-123 and USPS-LR-L-124. All amounts are in thousands of dollars.

- a) The TYAR revenue for Certified Mail is listed as 698,854. In witness O'Hara's testimony, Exhibit USPS-31B, the value is listed as 698,435. Please reconcile the difference.
- b) The TYBR revenue for Money Orders is listed as 215,027. In witness O'Hara's testimony, Exhibit USPS-31A, the value is listed as 230,401. Please reconcile the difference.

- e) The TYAR revenue for Registered Mail is listed as 60,607. In witness O'Hara's testimony, Exhibit USPS-31B, the value is listed as 60,573. Please reconcile the difference.
- f) The TYBR revenue for Stamped Envelopes is listed as 12,350. In witness O'Hara's testimony, Exhibit USPS-31A, the value is listed as 9,585. Please reconcile the difference.
- g) Please provide an itemized listing of the revenue items included in "other special services" in witness O'Hara's testimony, Exhibits USPS-31A and USPS-31B.

RESPONSE:

- a) The TYAR revenue of \$698,854 (in thousands) for Certified Mail in witness Berkeley's testimony is correct. Errata will be filed shortly to correct Exhibit USPS-31B.
- b) The TYBR revenue for Money Orders should be \$230,490 (in thousands), and the TYAR revenue for Money Orders should be \$242,185 (in thousands). Errata will be filed shortly.
- e) The TYAR revenue of \$60,607 (in thousands) for Registered Mail in witness Berkeley's testimony is correct. Errata will be filed shortly to correct Exhibit USPS-31B.

RESPONSE OF POSTAL SERVICE WITNESS BERKELEY (USPS-T-39) TO
PRESIDING OFFICER'S INFORMATION REQUEST NO. 3

- f) The TYBR revenue of \$12,350 (in thousands) for Stamped Envelopes in witness Berkeley's testimony is correct. Errata will be filed shortly to correct Exhibit USPS-31B.
- g) The itemized listing of the revenue items included in "other special services" in witness O'Hara's testimony, Exhibits USPS-31A and USPS-31B will be filed shortly.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA
TO INTERROGATORY OF UNITED PARCEL SERVICE**

Revised: August 28, 2006

UPS/USPS-T31-1. Are "product specific" costs attributable to the class of mail for which they are incurred?

RESPONSE:

It is my understanding that "product specific" costs are included in "attributable cost" under the Commission's costing methodology.

"Product specific" costs are also included in the "incremental cost" measure that the Postal Service uses to determine whether Criterion 3 is met by a given subclass. Please see my testimony at page 11, line 35 through page 12, line 9 for a brief description the incremental cost concept and how it differs from the Commission's attributable cost.

**RESPONSE OF THE UNITED STATES POSTAL SERVICE WITNESS O'HARA
TO INTERROGATORY OF UNITED PARCEL SERVICE**

UPS/USPS-T31-2. Are the "product specific" costs of a class or subclass of mail included in the cost base to which the markup determined by you and the Postal Service's pricing witnesses are applied in determining the total revenues to be recovered by that class of mail?

RESPONSE:

For the purpose of evaluating the relative contribution of various subclasses to institutional costs, the Postal Service examines the ratios of proposed revenue to volume-variable cost across subclasses. Volume-variable cost does not include "product specific" costs.

Given that Criterion 3 is satisfied, the Postal Service believes that unit volume-variable cost is the appropriate cost measure for evaluating the relationship between prices and cost with respect to the other criteria. The unit volume variable cost of a subclass measures the resources needed to provide an additional unit of service in each subclass and mailers use price to determine how much volume to mail in various subclasses.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA
TO INTERROGATORY OF VALPAK**

VP/USPS-T31-2.

Please refer to your testimony starting on page 12, line 21, through page 13, line 5, where you discuss the Availability of Alternatives (criterion 5).

- a. Would you agree that the availability of alternatives, including other media (which you mention), should be reflected in the own-price demand elasticity as shown in your Table B-1 on page 11? Please explain any disagreement.
- b. In your opinion, would the ready availability of alternatives at reasonable cost, and having a high (in absolute value) own-price elasticity of demand, argue for an increase or a decrease in coverage? Please explain.

RESPONSE:

- a. Yes.
- b. The own-price demand elasticities in my Table B-1 were estimated from national data on subclass mail volume and the factors that influence it. In effect, each elasticity reflects the national average availability of alternatives for its subclass. With respect to value of service (criterion 2), a high (in absolute value) elasticity argues for a relatively low cost coverage.

In my understanding, except where it may be applied because of a general dearth of postal alternatives, Criterion 5 (availability of alternatives) is applied primarily when the availability of alternatives for some portion of population is substantially below the national average (e.g., because they reside in rural areas). In such cases, the limited availability of alternatives for a portion of population argues for a somewhat lower coverage than would be indicated by the same own-price elasticity accompanied by a more-nearly uniform availability of alternatives for all segments of the population.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA
TO INTERROGATORY OF VALPAK**

VP/USPS-T31-3.

Please refer to your testimony at pages 13-14 with regard to the degree of preparation (criterion 6).

- a. Please confirm that, if 50 billion pieces have an attributable cost of 10 cents each, they will cause the Postal Service to incur a total attributable cost of \$5 billion. If you do not confirm, please provide the correct amount.
- b. Please confirm that, if those 50 billion pieces convert to workshared mail with an attributable cost of 6 cents each, they will cause the Postal Service to incur an attributable cost of only \$3 billion. If you do not confirm, please provide the correct amount.
- c. Please confirm that, if these 50 billion pieces pay their attributable costs of \$3 billion, plus a contribution to institutional costs of \$2.5 billion, the total revenue from these pieces will be \$5.5 billion, or 11 cents per piece. If you do not confirm, please provide the correct amount.
- d. Please confirm that under the scenario that you describe on page 13, line 20, through page 14, line 7, (i) the 50 billion workshared pieces would result in the Postal Service incurring \$3 billion of attributable costs and earning \$2.5 billion towards its overhead — i.e., markup (or gross profit margin) of 83 percent; and (ii) the 50 billion on non-workshared pieces would cause the Postal Service to incur \$5 billion of attributable costs, while earning \$2.5 billion towards its overhead — i.e., a markup (or gross profit margin) of 50 percent. Please explain any non-confirmation.
- e. Comparing the situations described by (i) and (ii) in preceding part d, would you agree that the 50 billion pieces of non-workshared mail would cause the Postal Service to incur an additional \$2 billion of attributable costs in order to earn the same \$2.5 billion contribution to institutional costs? Please explain any nonconfirmation.
- f. If the market for mail service were competitive, and the Postal Service were operating in a business-like manner as part of a competitive industry, would you expect an outcome such as that described in preceding part e? Or would you expect competition to equalize the rate of return on workshared and nonworkshared mail? Please explain.
- g. Please discuss the extent to which the Postal Service should attempt to establish coverages and prices for its products in a business-like manner, and the extent to which the Postal Service should ignore (or override) any such consideration.

RESPONSE:

- a. Confirmed for volume-variable costs.
- b. Confirmed assuming all of the costs are volume-variable.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA
TO INTERROGATORY OF VALPAK**

RESPONSE TO VP/USPS-T32-3 (continued):

c. Confirmed under the same assumption, although my testimony does not equate institutional cost contribution with gross profit margin.

d. Confirmed under the same assumption.

For ease of use in later parts of this question, note that the postage paid is:

\$5.5 billion (= \$3 + \$2.5) for workshared mail (83% markup), and

\$7.5 billion (= \$5 + \$2.5) for nonworkshared mail (50% markup);

a difference of \$2 billion.

e. Confirmed under the same assumption.

f. One preliminary point: This part of the question uses the term "rate of return" while referring to earlier parts of the question where the term "mark-up" is used. Although both are commonly stated as percentages, I do not understand them to be synonyms; to avoid unnecessary confusion I will not use rate-of-return in my response.

This part of the question posits that the Postal Service would be operating "as part of a competitive industry." This is a highly unrealistic assumption, but I will attempt to comply. The difficulty with the assumption is that, with the Postal Service's cost structure, marginal cost (= unit volume-variable cost) declines over the entire relevant range of output. This cost structure typically results in a "natural" monopoly of a single-firm (or perhaps a few firms that serve overlapping but not completely identical markets). If such a firm sets prices approximately equal to marginal cost, the revenue generated will not cover its

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA
TO INTERROGATORY OF VALPAK**

RESPONSE TO VP/USPS-T32-3 (continued):

total cost. So the firm must price above marginal cost and, if not regulated or otherwise constrained, will tend developed a price schedule that exceeds its total cost by the maximum amount possible (taking into account the extent to which higher prices make it economically attractive for its customers substitute other materials or services for the monopolist's product).

The Postal Service's pricing is constrained by the break-even constraint, but there are many different possible price schedule that will generate the required revenue. The process for determining what set of prices will actually be put in place is governed by the Postal Reorganization Act and guided by the nine pricing criteria therein.

By contrast, firms in competitive industry have a cost structure that may have declining marginal cost for small levels of output, but begins to display increasing marginal cost well before a firm's output is large enough to have a significant effect on the price generated by the market. As a result, such firms expand output no further than the point at which their marginal cost has risen to the market price. In a competitive industry, product prices tend to equal (not exceed) marginal costs, and the difference in price between two products tends toward the difference between their marginal cost.

So, if the Postal Service were operated in a business-like manner as part of a competitive industry, would I expect an outcome like that described in the earlier parts of this question? My answer is not necessarily. In your example, workshared mail costs the Postal Service \$2 billion less to process and deliver

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA
TO INTERROGATORY OF VALPAK**

RESPONSE TO VP/USPS-T32-3 (continued):

(\$3 billion vs. \$5 billion) than nonworkshared mail, and the postage it pays is also \$2 billion less. This conforms to the tendency for price differences to equal cost differences in a competitive industry, but it does not conform to the tendency for prices to equal marginal cost.

Please see also my responses to VP/USPS-T31-4&5, which provide additional comments on the extent to which the results generated by competitive markets can be usefully applied to *Postal Service pricing*.

- g. The aspect of business-like pricing that I believe has the greatest relevance to postal pricing is the general tendency for price differences between similar products to reflect cost differences. In the current postal context, if the two products in question are very similar with respect to the nine pricing criteria, there may be little reason to ignore or override the competitive industry tendency for price differences to equal cost differences. If, however, two products differ significantly with respect to the *nine criteria*, there may be ample reason for price differences to be greater than or less than cost differences.

Also, if the breakeven constraint were to be relaxed somewhat and eight of the nine pricing criteria removed, leaving only criterion three (no cross-subsidy), the Postal Service could well arrive at a price structure that differs significantly from today's structure without necessarily coming any closer to the kind of price structure that tends to arise in a competitive industry.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA
TO INTERROGATORY OF VALPAK**

VP/USPS-T31-4.

Please refer to your testimony concerning Standard Regular and ECR mail at page 26, line 19, through page 30, line 20.

- a. You state that Standard Regular has a relatively low intrinsic value of service (at p. 27, l. 1) and Standard ECR also has a relatively low intrinsic value of service (at p. 28, ll. 22-23). Do you have any reason to believe that the intrinsic value of service for Standard Regular is distinguishably higher or lower than it is for Standard ECR? If so, please explain the basis for your answer.
- b. If rates for Standard Regular and Standard ECR were set in competitive markets, would the coverages likely be similar to those that you have proposed, or would competition tend to reduce the coverage on ECR and, perhaps, increase it on Standard Regular, so as to make the rate of contribution on each more equal? Please explain.

RESPONSE:

- a. No.
- b. I do not think competitive markets would tend to make the "rate of contribution" for Standard Regular and Standard ECR more equal. (I assume "rate of contribution" refers to percentage coverage and/or percentage markup).

Competitive markets generate prices that move toward marginal costs, and thus relationships between product prices that tend toward the differences in their marginal costs. As a result, in a competitive market, the cost-coverage for each product tends toward 100%. This in turn does mean that cost coverages for different products tend to be equal, but what is important is the 100% (price equals marginal cost for each product); not the equality.

For products, such as postal services, whose marginal cost of production declines as volume increases, the revenue that would be obtained by setting coverages at the 100% generated by competitive markets will not be enough to cover total cost. The shortfall can be made up by non-product-related income (e.g., appropriations), or by coverages that, on average, exceed 100%, as is currently the case for the Postal Service.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA
TO INTERROGATORY OF VALPAK**

RESPONSE TO VP/USPS-T32-4 (continued):

One way to cover total cost would be to apply the required system-average cost coverage to each product individually; this would obviously result in equal coverages for any pair of products. However, it is likely that the "best" way of covering total cost will not entail equal coverages across all products even when "best" is defined solely by economic criteria.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA
TO INTERROGATORY OF VALPAK**

VP/USPS-T31-5.

Your testimony lists the ratemaking criteria of the Postal Reorganization Act at page 8, and discusses them at pages 9-15.

- a. After taking these criteria into account, please explain the extent to which you believe the Postal Service or the Commission can set rates or rate relationships emulating those which would obtain in a competitive market?
- b. Do you believe that the likely outcome under competition constitutes a reasonable criterion, or yardstick, to use when evaluating whether rate levels and rate relationships are fair and equitable?

RESPONSE:

- a. Several of the criteria instruct the Postal Service and the Commission to consider factors that competitive markets do not consider (e.g., fairness and equity (criterion 1), the effect of rate increases on enterprises providing close substitutes (criterion 4), and ECSI value (criterion 8)). I believe it highly unlikely that a careful consideration of these factors could result in rates that emulate "those which would obtain in a competitive market."
- b. No, both for the reasons mentioned in my response to part (a) and because I think it would be extremely difficult to determine what "the likely outcome under competition" would be with sufficient accuracy to provide a usable yardstick.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA
TO INTERROGATORY OF VALPAK**

VP/USPS-T31-6.

Your testimony (USPS-T-31) states: "ECR mail has a very high degree of preparation by the mailer (criterion 6); even the basic rate category must be line-of-travel sequenced, and the high-density and saturation categories are walk-sequenced." (Page 30, lines 1-3.)

- a. Please confirm that ECR basic rate mail may be either in walk-sequence or line-of-travel sequence (see DMM section.243.6.3.1).
- b. Please explain the additional work for mailers associated with putting mail in line-of-travel sequence and walk-sequence.
- c. Please confirm that there is no requirement that any Standard Regular mail be either line-of-travel sequenced or walk sequenced. If you cannot confirm, please identify which Standard Regular must be line-of-travel sequenced or walk sequenced.

RESPONSE:

- a. Confirmed.
- b. For the sequencing standards that must be met to qualify for the ECR line-of-travel and walk-sequence rate categories, see DMM 245.6.0 (letters) and 345.6.0 (flats). The additional work for mailers associated with meeting these requirements might best be explained by mailer witnesses. Since all ECR rate categories are optional, the mailer's cost for doing this work is presumably less than the associated rate differences for the pieces mailed in these categories.
- c. Confirmed.

1 CHAIRMAN OMAS: There are several late filed
2 responses that I would like to enter into the record
3 at this point in time. They are Valpak/USPS-T31-1 and
4 7 through 9; NAA/USPS-T31-9; and POIR No. 1, Question
5 12.

6 Mr. O'Hara, if you were asked to respond
7 orally to these questions here today, would your
8 answers be the same as you had provided previously?

9 THE WITNESS: Yes, they would.

10 CHAIRMAN OMAS: Including the Library
11 Reference 174?

12 THE WITNESS: Yes.

13 CHAIRMAN OMAS: With that, I am providing
14 two copies of those answers to the reporter and direct
15 that they be admitted into evidence and transcribed
16 into the record.

17 (The documents referred to
18 were marked for
19 identification as Exhibit
20 Nos. Valpak/USPS-T31-1 and 7
21 through 9, NAA/USPS-T-31-9,
22 and POIR No. 1, Question 12,
23 and were received in
24 evidence.)

25 //

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA
TO INTERROGATORY OF VALPAK**

VP/USPS-T31-1.

Please refer to page 13 of your testimony (USPS-T-13), at lines 16-19, where you say: "It is also worth noting that as the degree of preparation increases over time, all else equal, the coverage required to obtain the same contribution also increases. This is true for the system as a whole as well as for an individual subclass." You then go on to provide a numerical, but hypothetical, illustration of this phenomenon.

- a. Have you done any analysis of the absolute or the relative changes in the degrees of worksharing in the various subclasses of mail over time? If so, please present that analysis with its conclusions.
- b. The Commission provided a paper entitled, "Pricing Repositionable Notes (RPN) for Use in Postal Delivery Services: An Economic Analysis," by Professor Frank A. Wolak, dated January 16, 2006. See Docket No. MC2004-5, PRC-LR-1 Revised. In it, Professor Wolak looked to measures of consumers surplus for guidance on how RPNs should be priced. In other situations, the Commission has given weight to notions of efficient component pricing, which focus on getting the lowest-cost provider to do the work. Also, attention has also been given to the effectiveness of signals sent to mailers in rates and to the importance of marginal costs to the efficiency of resource allocation. Are you aware of any references to economic theory or to the economic literature which point to the efficacy of maintaining "the same contribution [on a per-unit basis]" from a subclass over time, as the costs of that subclass change? If you are, please provide those references.
- c. Please consider the following statement, not taken from any particular source: Requiring a pre-determined level of contribution from a subclass, either in total or on a per-piece basis, is an exercise akin to the schemes used by practitioners of fully distributed costing. Doing so is anathema to the economic principles of ratesetting, as it is a subtle way of identifying what appears to be responsibility and at the same time of diverting attention from pertinent factors that should guide decision making. It should be rejected on its face.
 - (i) Please indicate whether you agree or disagree with this statement, and explain the basis for any disagreement.
 - (ii) If you disagree with this statement, please provide references to economic concepts or literature pointing to any benefits you believe would result from adopting such a focus on maintaining contribution.
- d. Please suppose, in period 1, mailers submit mail requiring a wide range of services, including sorting, transporting, and delivering. Assume the Postal Service has adjusted its facilities and equipment to provide the desired services efficiently. Within the framework of this set of facilities and equipment, the Postal Service estimates its marginal costs, arrives at a level of total volume variable costs, and determines as a residual the level

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA
TO INTERROGATORY OF VALPAK**

VP/USPS-T31-1 (continued)

of its institutional costs. Now, please suppose, in period 2, the only changes are that mailers submit their mail downstream, and that it requires much less sorting and transporting. As would be expected, assume the Postal Service modifies its facilities and equipment to provide the reduced level of services efficiently. Within this modified framework of facilities and equipment, the Postal Service again estimates its marginal costs, arrives at a level of total volume variable costs, and determines as a residual the level of its institutional costs.

- (i) Please provide any bases you have for expecting that the level of institutional costs in the second period would be higher than, would be the same as, or would be lower than the level of institutional costs in the first period.
 - (ii) If you do not have any bases for forming expectations, even qualitatively, do you have any bases for ruling out certain outcomes? If so, please explain any such bases and point to any way you believe the outcome would be constrained.
- e. Please suppose a firm in a certain city is providing delivery services in competition with the Postal Service, and the arrangement is that customers prepare their mail in a certain way and bring it to that city. The firm bases its rates on its direct costs and a level of contribution it believes workable. Please suppose also that the Postal Service's competing product is one that has, over the last five years, become highly workshared, due to investments by mailers in preparation activities and downstream entry. Please explain the extent to which you believe the appropriate competitive posture for the Postal Service in this situation would be to set rates equal to current costs plus a pre-determined contribution rooted in circumstances now five years old.
- f. In Docket No. MC95-1, Postal Service witness McBride, in regard to the then proposed ECR subclass, said: "As the Postal Service is faced with *increasing competition for hard copy delivery, the most likely incursions* into the existing customer and volume base will occur in those areas where the unit cost for delivery is less than the average but is not adequately reflect in price, giving competitors an opportunity to price their services to attract the lower cost Postal Service products out of the mailstream." USPS-T-1, p. 29, ll. 16-21.
- (i) Please explain any extent to which you disagree with this quote from witness McBride.
 - (ii) It could be suggested that your prescription for developing rates is one of preserving legacy contribution levels and "giving competitors an opportunity to price their services to attract the lower cost Postal Service products out of the mailstream." Please explain any extent to which you disagree with this suggestion.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA
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RESPONSE to VP/USPS-T31-1

As you note, the cited portion of my testimony is a hypothetical example; in most such examples (including this one), the critical hypothesis is "other things unchanged" or "all else equal." This simplifies the discussion and analysis, but any real-world application of the concepts discussed will necessarily be more complicated than the example.

- a. I have done nothing that could be called analysis, but even a general familiarity with mailer response when new worksharing opportunities were offered (e.g., barcoding (or automation) and dropship discounts) suggests to me that worksharing has increased substantially over the past two decades.
- b. I know of no literature that directly addresses the Postal Service case, but maintaining the same contribution as cost change is consistent with the Efficient Component Pricing (ECP) literature, which was developed in the context of public utility regulation and can be (and has been) applied to the Postal Service.

ECP is directed at providing the right price incentives to induce customers to do a particular operation (e.g., sorting mail from the 3-digit level to the 5-digit level) whenever they can do it at less cost than the Postal Service. To continue with the 3-digit/5-digit example, this will happen if the difference between the rate for mail presorted to the 3-digit level and the rate for mail presorted to the 5-digit level is equal to the Postal Service's cost of doing the additional step itself (i.e., 100% pass-through of postal

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA
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RESPONSE to VP/USPS-T31-1 (continued):

cost differences to rate differences.

With 100% pass-through, increased mailer performance of the sort to 5-digits within a subclass will reduce subclass costs, but leave contribution unchanged. Customers doing the 5-digit sort are rewarded by the full amount of the Postal Service savings but no more; their contribution to institutional cost does not change.

- c. (i) I disagree. Fully-distributed costing distributes "overhead" costs (or institutional cost in a Postal Service context) in proportion to various products' volume-variable or attributable costs. For the Postal Service, eight of the nine pricing criteria provide guidance on how institutional cost should be distributed, and none of these eight suggest any particular relationship between a subclass' volume-variable cost and its appropriate share of institutional cost.

(ii) Please see my response to part (b) of this question. Also, I do not recommend "(r)equiring a pre-determined level of contribution from a subclass." As explained in my response to part (f) below; I do recommend pre-existing contribution levels as a better starting point than pre-existing cost coverages for determining how the level of contribution across various subclasses should be modified by the application of the eight non-cost-related pricing criteria to changes in circumstances.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA
TO INTERROGATORY OF VALPAK**

RESPONSE to VP/USPS-T31-1 (continued):

- d. (i) & (ii) Since the only things that change are (1) an increase in downstream entry and (2) the Postal Service adjustments needed to provide the reduced level of service efficiently, I would expect the level of institutional cost to be the same in both periods. Institutional cost is by definition not volume-variable, the fact that it is "residual" is calculated by subtracting total volume variable cost from Total Cost. Both Total Cost and total volume-variable cost will be lower in period 2, but the difference between them will be the same as it was in Period 1 (Among "others things unchanged," perhaps the most important would be the prices the Postal Service pays for the various inputs used by activities that make up institutional cost, e.g., cost per workhour, per kilowatt hour of electricity, etc.).
- e. Determining whether or not the Postal Service should maintain a pre-existing contribution level for this subclass requires a balancing all the statutory pricing factors across all the subclasses. Although reducing the unit contribution of this subclass would reduce total contribution as well (unless the reducing would draw volume from the competitor, which seems contrary to your assumptions), the reduced contribution might be above the contribution that would result from retaining the pre-existing unit contribution. For this to be the case, a small difference in price (from reduced unit contribution) would have to have a fairly large effect on the amount mail diverted to the alternate carrier.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA
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I only recommend pre-existing contribution levels a good starting point for determining the appropriate distribution of contribution in light current circumstances. Major changes in the alternatives available to users of a particular subclass over the past five years may well make for greater changes in the appropriate distribution of institutional cost. The question should be decided on the basis of how shifts in the distribution will affect *the various subclasses, not from a "competitive posture" targeted on maintaining volume or market share per se.*

- f. (i) I agree with witness McBride; note that he refers to "areas where the unit cost for delivery is less than the average but is not adequately reflected in price" (emphasis added). The unit cost of delivery is part of a product's volume-variable cost, both for products with a below-average unit cost of delivery and for products with an above-average unit cost of delivery.
- (ii) My discussion of contribution levels is not a prescription. My objective was to demonstrate by an "all-else-equal" example that preserving legacy contribution levels may be a better starting point for adjusting rates after worksharing has increased than preserving legacy cost coverages. In this situation, starting with cost coverages from the *previous rate-case means starting with a distribution of institutional cost that differs from* the distribution that was determined to comply with the pricing criteria of §3622(b) in that case.

In particular, the burden of institutional cost will be shifted to subclasses with above-average cost increases. In the example, above-average cost increases resulted from below-average increases in worksharing.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA
TO INTERROGATORY OF VALPAK**

RESPONSE to VP/USPS-T31-1 (continued):

However, above-average cost increases may result from limits on worksharing opportunities (e.g., dropship discounts are not available Medial Mail), or because the Postal Service has deployed new technology that reduces costs for some subclasses but has little effect on others (e.g., letter automation for subclasses that have very few letter-shaped pieces, such a Periodicals).

I do not recommend that legacy contribution level be carved in stone. But I do think that pre-existing contribution levels provide a good starting-point for developing a new set of contribution levels that respond to new conditions.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA
TO INTERROGATORY OF VALPAK**

VP/USPS-T31-7.

Please refer to your response to OCA/USPS-T31-1, where you state that your decisions in establishing cost coverages were informed by your knowledge about (i) "applicable service standards for various products," and (ii) "the available data regarding the Postal Service's experiences in meeting these standards."

- a. Please explain how your decision in establishing the cost coverage for Standard Regular and Standard ECR was informed by the service standards for Standard Mail.
- b. Please identify all available data (or other information) that you relied on regarding the Postal Service's experiences in meeting the Standard Mail service standards.

RESPONSE:

- a. The proposed coverages for Standard Regular and Standard ECR were *developed simultaneously with coverages for the other subclasses*. A major consideration was to facilitate acceptance of the Postal Service's proposed rate and classification changes (summarized on pages 3-6 of my testimony) within the framework of the § 3622(b) criteria. Accordingly, particular attention was given to criterion 4 (effect of rate increases)

Because the service standard for Standard Mail is unchanged, and there have been *no changes in service performance relative to that standard as far as I am aware*, the proposed coverages do not incorporate any service-related adjustments.

- b. There are no nationally representative data on Standard Mail performance relative to service standards. For other information, please see my testimony (revised August 25, 2006) at page 27, lines 8-16 (for Standard Regular) and page 29, lines 7-12.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA
TO INTERROGATORY OF VALPAK**

VP/USPS-T31-8.

Please refer to your response to OCA/USPS-T31-3. You state:

[A]verage delivery time is not the only aspect of service performance that matters to customers. Variation around the average can also be important.

- a. What is the variation of actual average delivery time around the service standard for delivery of Standard Regular Mail, e.g., for Standard Mail with a stated service standard of seven days, what is the actual average number of days for delivery?
- b. Please provide all statistical measures or anecdotal information that the Postal Service has regarding the variation of the actual average time versus the service standard for delivery of Standard Regular Mail.

RESPONSE:

- a. No measure of this variation is available.
- b. No statistical measures are available. My understanding, based on many discussion with mailers, printers, and people in Operations within the Postal Service is that an acceptably small level of variation is usually, but not always, achieved. For Standard Regular, dropship to the Destination Sectional Center Facility (DSCF) is widely believed to be effective in reducing variation in when mail is delivered. Standard Regular mail that is entered anywhere upstream from the Destination Bulk Mail Center (DBMC) is believed to have wider variation in day of delivery, with a small portion (referred to as "the tail of the mail") sometimes being delivered several days after the requested delivery window.

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TO INTERROGATORY OF VALPAK**

VP/USPS-T31-9.

Please refer to your response to ABA-NAPM/USPS T31-1. The primary purpose of this question is to help clarify the meaning of certain figures in your response.

- a. For each year for which data are shown, please identify clearly:
 - (i) whether the data are at Postal Service or Commission costing;
 - (ii) whether the data are actual outcomes or projections;
 - (iii) if at Postal Service costing, whether the data are at proposed costing in a pending case, the costing proposed in a recent rate case, or some other specified costing; and
 - (iv) if at Commission costing, whether the data are at costing actually developed and used by the Commission during some specified rate case, or at a Postal Service estimate of Commission costing from some previous rate case.
- b. For any data that constitute projections, please explain the extent to which you agree that differences between any year and a projected year are at least in part the result of (or a reflection of) assumptions made in a model and thus may have little or nothing to do with what actually happened to the Postal Service in those years.
- c. For each year, or applicable portion of a year, for which any data shown include revenue and cost for Nonprofit mail, please state whether the Nonprofit rates were set pursuant to Public Law 106-384, or Public Law 103-123, or some other law.
- d. In section 2 of your response, you state: "Your data for Standard Mail in 1999 (and **presumably** for 1994 – 1998 as well) are for the commercial portions of Regular and ECR." (Emphasis added.)
 - (i) Please identify any questions you have about what the data for 1994 through 1998 are for.
 - (ii) The original question asked you to "confirm" the figures provided in the question. Please clarify the extent to which you have checked and are confirming the various figures.
- e. In section 2 of your response, you "recommend aggregating data from the earlier years to the level of detail reported beginning in FY 2000" in order "[t]o get an apples-to-apples comparison of coverages before and after FY 2000."
 - (i) Please state what assumptions have to be met to make the comparisons apples-to-apples.
 - (ii) Please explain whether the appropriateness of the comparisons at issue are affected by any assumption about who pays for the reduced rates for the Nonprofit mailers (candidates for paying to include all mailers combined or the host commercial category).
 - (iii) Please explain whether the appropriateness of the comparisons at issue is affected by any assumption about whether the rates set for the Nonprofit categories under Public Law 106-384 are the same as the rates that would have been set under Public Law 103-123.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA
TO INTERROGATORY OF VALPAK**

VP/USPS-T31-9 (continued)

- f. Please explain the extent to which you believe significance attaches to the behavior over time of the ratios in each "Compared to Average" column in your response. If you believe there is significance, please state what that significance is. If you do not believe there is significance, please explain all reasons why not. (Note that this question does not relate to whether there is significance in the behavior over time of the markup index used by the Commission.)
- g. Please explain the extent to which you agree that any data relating to outcomes instead of to Postal Service proposals, or to recommendations of the Commission, do not relate specifically to what the Postal Service intended in its proposal or to what the Commission intended in its recommendation.
- h. (i) Which figures in your response are influenced in any way by decisions made by the Postal Service Governors or the Commission in Docket No. R2005-1?
(ii) Please explain the extent to which you agree that, because of the across-the-board nature of Docket No. R2005-1, none of figures itemized above in part (i) of this question have any content relating to coverage preferences of the Postal Service or to specific coverage recommendations of the Commission.

RESPONSE:

My responses to this question will refer to my suggested substitute table on page 2 of the attachment to this response, a table for which I can make definite statements. With two exceptions mentioned in my response to part (a), the coverages in my table are very close to those in the original table supplied as part of ABA-NAPM/USPS T31-1.

Also, I would note that the original table had a list of sources that I failed to reproduce in my response:

Source: R97-1, ABA/EEI/NAPM-T-1, Page 37; USPS, Cost and Revenue Analysis, Fiscal Year 1994 through 2005; for 2007, revenues are from R2006-1, USPS-LR-L-131, Exhibit USPS-31C and volume variable costs are from R2006-1, USPS-T-10, Exhibit USPS-10I. TY2008 data are from R2006-1, LR-L-131, Exhibit USPS-31B.
* Values for 2006 are from R2005-1, TY2006, USPS-T-27, Exhibit USPS-27B.

- a. (i) All data are from Postal Service documents and reflect the Postal Service costing methodology in use at the time. For the first three years of the table, differences between the Postal Service and PRC methods were quite small.

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RESPONSE to VP/USPS-T31-9 (continued):

- (ii) For the years 1994-2005, the data reflect actual outcomes. For 2006-2008, the data are R2006-1 projections, which are contained in my L-LR-174.
- (iii) In the original interrogatory, data for 2006 came from R-2005-1 and for 2007-2008 from R-2006-1 (as originally filed). The data for 2006-2008 in my suggested alternative (p. 2 of the attachment) are all from R-2006-1 and incorporate post-filing errata.

The data for 2006 in my alternative are based on different underlying assumptions from those in the ABA-NAPM table. The ABA-NAPM data are projected R2005-1 TYAR results, with rate implementation assumed to occur on October 1, 2005, whereas my alternative data are R2006-1 projections based on the actual implementation date of January 8, 2006 (and more recent economic data as well).

The other notable difference between the ABA-NAPM table and my alternative occurs in the columns for Standard Regular and Standard ECR for the years 1994 through 1999. The coverages in my table were constructed by combining revenues and costs for (commercial) Regular and Nonprofit for the "Regular" column and ECR and NECR for the "ECR" column. This aligns the data for 1994-1999 with those from 2000 forward, when cost data were reported only for these commercial/nonprofit combinations.

- (iv) Not applicable.

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RESPONSE to VP/USPS-T31-9 (continued):

- b. I would agree that differences in cost coverage between a pair of years, one a past year with actual results and the other a future year with projected results, will reflect the assumptions used in the future-year projections. Once the future year has ended, actual results may be compared with the projection. The actual results for a future year certainly may differ from the projection, but I know of no way to predict the size and direction of the difference.

- c. In my alternative table, which does contain Nonprofit data for all years, rates for the years 1994 through 2000 were determined under the applicable phasing legislation (Public Law 103-123), as were the rates in effect prior to January 7, 2001 in FY 2001. The R 2000-1 rates implemented on that date were determined by Public Law 106-384, which applies to all subsequent years in the table.

- d.
 - (i) As noted in my response to part (a), subpart (iii), the coverages in my alternative table are based on revenues and costs for Regular and Nonprofit combined and ECR and NECR combined. Since my coverages for 1994-1999 are significantly lower than the ABA-NAPM coverages, I believe that the "presumably" in my original response is correct, but I have not tried to replicate the ABA-NAPM coverages
 - (ii) All of the data in my alternative table have been drawn directly from USPS documents in electronic or hard-copy form. Aside from the differences noted in parts (a)-(iii) and (d)-(i), almost all the differences between the ABA-NAPM table and mine are small enough to result from differences in the number of digits used in the underlying revenue and cost data. There

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA
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RESPONSE to VP/USPS-T31-9 (continued):

are a few larger differences for the years 1994-1996 in the First-Class data that I suspect result from keying errors, but I have not confirmed this.

- e. (i) By "apples-to-apples" I simply meant that all the data in a given column should cover the same mail. Since separate cost data for commercial and nonprofit Standard are not available from 2000 forward, I suggested combining commercial and nonprofit data for the earlier years. Your mention of the nonprofit phasing legislation reminded me that relationship between commercial and nonprofit coverages changed over the phasing period, so my suggestion is not as completely "apples-to-apples" as I had thought. However, I still think it is more useful than excluding nonprofits for 1994-1999, and including them from 2000 on.
- (ii) I believe it is not possible in practice to determine who pays for reduced nonprofit rates. In theory, it might be able to make this determination, but I believe any theoretical approach would have to make numerous assumptions, of unknown validity, to arrive at a result other than "it depends on . . ."
- (iii) A part of any assessment of comparisons should be made with a knowledge of the law(s) in effect for the time period considered. I cannot come to any broad conclusion with respect to the relevance of knowledge (or assumptions) about whether the rates that would arise under different laws would or would not be the same.

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RESPONSE to VP/USPS-T31-9 (continued):

With respect to the years covered by the table, my understanding is that
(1) the early phasing years were designed to produce rates that were
lower relative to commercial rates than was thought appropriate on a long-
term basis, and

(2) the new law was negotiated with the intention of preserving, on
average, the relative position of nonprofit and commercial rates that had
been achieved at the end of phasing, but without the rate-case to rate-
case jumps in the relationship that seemed likely to be a continuing
problem unless modifications were made to the mechanism specified in
the existing law.

- f In my view, the behavior over time of the ratios in each "Compared to Average"
column does not "speak for itself," and no general conclusion with respect to its
significance is possible.

- g Of course, neither the Postal Service nor the Commission can predict the future
precisely enough to propose or recommend rates that actually result in
coverages that match those implied by their underlying analysis. However,
absent major unanticipated events (such as 9-11-2001), I believe that actual
coverages tend to move in the same direction as the proposed coverages, and
that actual outcomes can often be used, with your caveat, for analysis.

- h.
 - (i) The data for 2006-2008 are influenced by results of R 2005-1.
 - (ii) I believe the across-the-board nature of Docket No. R2005-1 means that
the resulting coverages (both proposed and recommended) have a less
precise relationship to the coverage preferences of the Postal Service or

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA
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RESPONSE to VP/USPS-T31-9 (continued):

the Commission than those in an ordinary omnibus rate case, but I cannot agree that they lack "any content." I believe that both the Postal Service and the Commission would not have proposed or recommended the R2005-1 rates unless they judged the resulting coverages to be within the acceptable range, at least for the period they were likely to be in effect.

Table accompanying ABA-NAPM-T31-1

**Recent Cost Coverages For First Class and Standard A Mail
Compared to System-Wide Average for All Mail & Special Services
Cost Coverage**

Year	System-Wide Average	First-Class Mail			Standard Mail		
		Total	Piece Single-	Presort	Total	Regular	ECR
1994	155%	167%	150%	216%	148%	131%	217%
1995	163%	173%	151%	247%	157%	140%	227%
1996	164%	175%	150%	262%	159%	144%	230%
1997	181%	204%	182%	275%	166%	154%	242%
1998	179%	209%	186%	276%	161%	142%	248%
1999	168%	196%	175%	259%	149%	136%	207%
2000	171%	202%	174%	280%	156%	135%	220%
2001	171%	202%	173%	278%	157%	135%	233%
2002	173%	207%	176%	286%	157%	137%	224%
2003	186%	218%	181%	314%	175%	152%	263%
2004	185%	219%	180%	321%	174%	154%	245%
2005	176%	210%	172%	301%	172%	160%	204%
2006*	188%	227%	187%	332%	178%	160%	244%
2007	181%	217%	177%	309%	178%	168%	209%
TY08AR	188%	226%	183%	317%	185%	177%	213%

Year	System-Wide Average	Compared to Average			Compared to Average		
		Total	Piece Single-	Presort	Total	Regular	ECR
1994	155%	1.08	0.97	1.39	0.95	0.85	1.40
1995	163%	1.06	0.93	1.52	0.96	0.86	1.39
1996	164%	1.07	0.91	1.60	0.97	0.88	1.40
1997	181%	1.13	1.01	1.52	0.92	0.85	1.34
1998	179%	1.17	1.04	1.54	0.90	0.79	1.39
1999	168%	1.17	1.04	1.54	0.89	0.81	1.23
2000	171%	1.18	1.02	1.64	0.91	0.79	1.29
2001	171%	1.18	1.01	1.63	0.92	0.79	1.36
2002	173%	1.20	1.02	1.65	0.91	0.79	1.29
2003	186%	1.17	0.97	1.69	0.94	0.82	1.41
2004	185%	1.18	0.97	1.74	0.94	0.83	1.32
2005	176%	1.19	0.98	1.71	0.98	0.91	1.16
2006*	188%	1.21	0.99	1.77	0.95	0.85	1.30
2007	181%	1.20	0.98	1.71	0.98	0.93	1.15
TY08AR	188%	1.20	0.97	1.69	0.98	0.94	1.13

Source: R97-1, ABA/EEI/NAPM-T-1, Page 37; USPS, Cost and Revenue Analysis, Fiscal Year 1994 through 2005; for 2007, revenues are from R2006-1, USPS-LR-L-131, Exhibit -31C and volume variable costs are from R2006-1, USPS-T-10, Exhibit USPS-101. TY2008 data are from R2006-1, LR-L-131, Exhibit USPS-31B.

* Values for 2006 are from R2005-1, TY2006, USPS-T-27, Exhibit USPS-27B.

Alternative table prepared by witness O'Hara

Recent Cost Coverages For First Class and Standard Mail
Compared to System-Wide Average for All Mail & Special Services

Year	System-Wide Average	First-Class Mail Letters			Standard Mail		
		Total	Single-Piece	Presort	Total excl. SP	Regular + NP	ECR + NECR
1994	155%	162%	147%	209%	149%	125%	209%
1995	163%	168%	151%	227%	158%	133%	223%
1996	164%	178%	154%	262%	160%	136%	226%
1997	181%	205%	182%	275%	168%	144%	234%
1998	179%	209%	186%	276%	163%	136%	240%
1999	168%	197%	175%	259%	149%	131%	201%
2000	171%	202%	174%	280%	155%	135%	220%
2001	171%	203%	173%	278%	156%	135%	233%
2002	173%	207%	176%	286%	156%	137%	224%
2003	186%	218%	181%	314%	174%	152%	263%
2004	185%	220%	180%	321%	173%	156%	245%
2005	176%	211%	172%	301%	172%	160%	204%
FY06BR	176%	214%	174%	303%	173%	162%	207%
FY07AR	181%	220%	177%	309%	178%	168%	209%
FY08AR	189%	229%	186%	312%	185%	176%	214%

Year	System-Wide Average	Compared to Average			Compared to Average		
		Total	Single-Piece	Presort	Total excl. SP	Regular + NP	ECR + NECR
1994	155%	1.05	0.95	1.35	0.96	0.81	1.35
1995	163%	1.03	0.93	1.39	0.97	0.82	1.37
1996	164%	1.09	0.94	1.60	0.98	0.83	1.38
1997	181%	1.13	1.01	1.52	0.93	0.80	1.30
1998	179%	1.16	1.04	1.54	0.91	0.76	1.34
1999	168%	1.17	1.04	1.54	0.89	0.78	1.19
2000	171%	1.18	1.02	1.64	0.91	0.79	1.28
2001	171%	1.18	1.01	1.62	0.91	0.79	1.36
2002	173%	1.20	1.02	1.65	0.90	0.79	1.29
2003	186%	1.17	0.97	1.69	0.94	0.82	1.41
2004	185%	1.19	0.97	1.73	0.93	0.84	1.32
2005	176%	1.19	0.97	1.71	0.97	0.91	1.16
FY06BR	176%	1.22	0.99	1.72	0.99	0.92	1.18
FY07AR	181%	1.21	0.98	1.71	0.98	0.93	1.16
FY08AR	189%	1.21	0.99	1.66	0.98	0.94	1.14

Sources

FY 1994 through FY 2005: USPS Cost and Revenue Analyses & Cost Segments and Components reports for the indicated years

FY06BR USPS-LR-L-174, _BR Rate Level Workpapers.xls, tab "BR 2006 Rev & Cost"

FY07AR USPS-LR-L-174, _AR Rate Level Workpapers.xls, tab "AR 2007 Rev & Cost"

FY08AR USPS-LR-L-174, _AR Rate Level Workpapers.xls, tab "AR 2008 Rev & Cost"

Difference between ABA-NAPM table (p. 1) and witness O'Hara alternative (p. 2)

Year	System-Wide Average	First-Class Mail			Standard Mail		
		Total	Piece-Single-	Presort	Total	Regular	ECR
1994	-0.2%	-4.9%	-3.2%	-6.6%	1.1%	-6.1%	-7.5%
1995	-0.2%	-4.9%	0.1%	-20.2%	1.2%	-6.8%	-4.4%
1996	-0.3%	3.0%	3.5%	-0.2%	1.2%	-8.0%	-4.1%
1997	-0.5%	0.8%	-0.4%	-0.3%	2.5%	-9.9%	-8.0%
1998	0.3%	-0.4%	-0.2%	0.5%	1.9%	-5.9%	-8.4%
1999	0.3%	1.1%	0.0%	0.2%	0.2%	-5.1%	-6.5%
2000	0.4%	0.3%	0.3%	0.5%	-0.8%	0.0%	0.0%
2001	0.3%	0.5%	0.5%	0.0%	-0.7%	0.4%	0.2%
2002	0.2%	0.3%	0.1%	0.4%	-1.1%	-0.1%	-0.2%
2003	0.3%	0.4%	-0.4%	0.4%	-0.7%	0.1%	-0.1%
2004	0.5%	1.2%	0.2%	-0.1%	-0.8%	2.4%	-0.3%
2005	0.4%	0.7%	-0.3%	-0.1%	-0.1%	-0.1%	0.0%
2006	-12.2%	-12.6%	-12.6%	-29.0%	-4.5%	2.5%	-37.2%
FY07AR	-0.1%	2.7%	0.4%	-0.4%	-0.1%	0.3%	0.4%
FY08AR	0.7%	2.7%	3.4%	-4.7%	-0.2%	-0.5%	1.2%

Please see the discussion of the differences between the two tables in the Response to VP/USPS-T31-9, especially part (a)-(iii)

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA
TO INTERROGATORY OR NEWSPAPER ASSOCIATION OF AMERICA**

NAA/USPS-T31-9.

Please refer to your response to ABA-NAPM/USPS-T31-1, filed August 4, 2006. For the categories of mail presented in that interrogatory, please provide the average unit contribution per piece (as measured by the Postal Service, that is, revenue minus volume variable cost) for the years 1994 through FY2007BR.

RESPONSE:

Unit Contribution For First Class and Standard Mail

Year	Total Mail	First-Class Mail <u>Letters</u>			Standard Mail		
		Total	Single-Piece	Presort	Total <u>excl.</u> <u>SP</u>	Regular + NP	ECR + <u>NECR</u>
1994	0.087	0.115	0.109	0.127	0.032	0.011	0.054
1995	0.094	0.133	0.128	0.142	0.040	0.027	0.056
1996	0.097	0.135	0.129	0.144	0.045	0.026	0.066
1997	0.094	0.117	0.109	0.128	0.022	(0.017)	0.066
1998	0.109	0.133	0.129	0.140	0.159	0.167	0.150
1999	0.110	0.156	0.131	0.196	0.063	0.050	0.079
2000	0.131	0.175	0.178	0.171	0.059	0.057	0.079
2001	0.130	0.178	0.187	0.166	0.061	0.044	0.082
2002	0.122	0.172	0.176	0.167	0.054	0.042	0.071
2003	0.126	0.177	0.177	0.177	0.061	0.048	0.078
2004	0.128	0.179	0.178	0.179	0.064	0.050	0.084
2005	0.133	0.188	0.188	0.188	0.066	0.053	0.084
FY06BR	0.141	0.208	0.250	0.212	0.083	0.080	0.087
FY07BR	0.141	0.202	0.205	0.214	0.082	0.080	0.087
TY08AR	0.165	0.235	0.242	0.230	0.100	0.100	0.100

Sources:

FY 1994 through FY 2005: USPS Cost and Revenue Analyses & Cost Segments and Components reports for the indicated years

FY06BR: USPS-LR-L-174, _BR Rate Level Workpapers.xls, tab "BR 2006 Rev & Cost"

FY07BR: USPS-LR-L-174, _BR Rate Level Workpapers.xls, tab "BR 2007 Rev & Cost"

TY08AR: USPS-LR-L-174, _AR Rate Level Workpapers.xls, tab "AR 2008 Rev & Cost"

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS O'HARA
TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 1**

12. In support of Exhibits USPS-31A, USPS-31B and USPS-31C, please provide workpapers for Fiscal Years 2005, 2006, 2007, and 2008 that show for each mail category and special service the following statistics and their sources: (a) mail volume, (b) postage, (c) fees, (d) total revenue, and (e) revenue per piece. The requested workpapers should have a similar structure as Postal Service witness Taufique's Exhibit USPS- 28A, Tables 11 and 12 in Docket No. R2005-1.

RESPONSE

Please see USPS Library Reference L-174. The worksheets with "Vol & Rev" in their names provide the requested data. Information for BY 2005, FY 2006, FY 2007 BR, and TY 2008 BR are in the "BR" spreadsheet, and information for FY 2007 AR and TY 2008 AR are in the "AR" spread sheet.

1 CHAIRMAN OMAS: Is there any additional
2 written cross-examination for Witness O'Hara?

3 MR. BAKER: Mr. Chairman?

4 CHAIRMAN OMAS: Mr. Baker, please identify
5 yourself and who you represent.

6 MR. BAKER: William Baker with the Newspaper
7 Association of American.

8 I may have dozed off a moment there. Did
9 you just put in NAA-9?

10 CHAIRMAN OMAS: NAA-9. Correct.

11 Is there any additional written cross-
12 examination of Witness O'Hara?

13 (No response.)

14 CHAIRMAN OMAS: There being none, this
15 brings us to oral cross-examination.

16 Amazon.com filed a motion for late
17 acceptance of its request to cross-examine. That
18 motion is granted.

19 That means that nine parties are scheduled
20 today to cross-examine Witness O'Hara. Rather than
21 read them all as I usually do, I think we will start
22 at the top of the list and go down.

23 Amazon.com, Mr. Olson?

24 Before Mr. Olson begins, is there any other
25 participant in the hearing room this morning who would

1 like to cross-examine Witness O'Hara?

2 (No response.)

3 CHAIRMAN OMAS: There being none, Mr. Olson,
4 you may begin.

5 MR. OLSON: Thank you, Mr. Chairman, for
6 granting the motion.

7 CROSS-EXAMINATION

8 BY MR. OLSON:

9 Q Dr. O'Hara, Bill Olson for Amazon.com. I'd
10 like to ask you to look at your testimony at page 33,
11 lines 14 and 15 --

12 A Yes.

13 Q -- where you say, "Over a period of years,
14 an increasing number of books have been mailed as
15 BPM." Do you see that?

16 A Yes.

17 Q Do you know how long that trend has been
18 going on offhand?

19 A I know it starts way back when there were
20 certain regulations about how much advertising you had
21 to have in something to qualify for bound printed
22 matter.

23 I don't know much about recent trends. The
24 last discussion I remember hearing was internally in
25 connection with bound printed matter a few years back

1 where people were concerned that although the
2 preliminary contents of what was in the box was bound
3 printed matter, specifically books often for children,
4 that in there also was a game or a toy or a doll as
5 well not contrary to regulations, but something that
6 would be increasing the bulk of the package without
7 much increasing its weight, but I haven't heard about
8 that one either very recently.

9 Q Were you aware of oral cross by Amazon.com
10 of Witness Yeh on this issue?

11 A Not until yesterday evening when my counsel
12 mentioned it to me, but that's all I can say.

13 Q Your name came up.

14 A Uh-huh.

15 Q And we discussed the Household Diary survey
16 or study -- I can never remember which it's called --
17 as a source, and there was some testimony by Witness
18 Mayes apparently in R2000-1. Have you had a chance to
19 look at those at all?

20 A I've certainly had a chance. I think a good
21 thing the Postal Service has continued to do on a
22 regular basis, not something we always do as
23 frequently as I'd like, but in terms of keeping up
24 with the last few years, let alone any specific page,
25 no, I haven't studied them.

1 MR. OLSON: We asked Witness Yeh to get back
2 to us with respect to that, and the Chairman followed
3 up. It's at Volume 8, pages 1996 and 1997, which was
4 on August 11.

5 I admit there was no specific date specified
6 for a response. Mr. Chairman, would it be appropriate
7 to ask Postal Service counsel for an update?

8 CHAIRMAN OMAS: Yes, by all means, but I
9 think I did give them seven days at that time, didn't
10 I, as far as it was to be presented to us within seven
11 days?

12 MR. OLSON: In fairness, at that time I
13 didn't specify seven days, and the Chairman didn't
14 specify seven days. It just said, "If you could
15 provide that to us we'd be most appreciative." That
16 was your exact phrase.

17 CHAIRMAN OMAS: Thank you.

18 Mr. Tidwell?

19 MR. TIDWELL: I can at the earliest
20 opportunity inquire back at the office to see what the
21 status of that request is.

22 CHAIRMAN OMAS: Could you do that and get
23 back to us after our morning break?

24 MR. TIDWELL: I will do that.

25 CHAIRMAN OMAS: I appreciate that. Thank

1 you.

2 MR. OLSON: I emailed Mr. Reiter yesterday,
3 but hadn't heard back yet. That would be helpful.
4 Thank you.

5 BY MR. OLSON:

6 Q Have you discussed the issue of the
7 percentage of books and BPM with Witness Yeh or
8 Witness Thress for example?

9 A No. No, I haven't.

10 Q Have you examined any data or do you know of
11 any data on the topic that are recent?

12 A I do not. I don't know of any systematic
13 data at all. Whatever is in the box, presumably by
14 the mailer's statement, meets the qualifications for
15 the class, but they can do that with a wide variety of
16 printed matter.

17 I don't think we collect any systematic or
18 even occasional information on the contents of bound
19 printed matter, and I don't know of anyone else that
20 does that except the Household Diary might have
21 something.

22 Q Do you recall that in R2000-1 there was some
23 discussion of this issue?

24 AAP proposed that the percentage was I
25 believe 63 percent was their number now that I see

1 their notes. The Postal Service reply brief said that
2 books were only 52 percent of BPM. Do you recall
3 those numbers offhand?

4 A I don't recall hearing about the time. It
5 doesn't ring a bell.

6 I'm real curious to find out what the source
7 of that was, especially when it's 62, not sort of over
8 half. That's a fairly precise number. It sounds like
9 there ought to be something behind that.

10 Q Just for clarification, AAP argued 63
11 percent based on the Household Diaries survey. The
12 Postal Service reply brief said that books were only
13 52 percent of BPM.

14 A Okay.

15 Q Let me ask you this. To the best of your
16 knowledge, would you say that books constitute at
17 least as large a share of BPM now as they did five
18 years ago?

19 A I guess I don't really know anything that
20 would let me have an opinion on that one way or the
21 other.

22 Q From what I think you've said, to your
23 knowledge the Postal Service has no data that you're
24 aware of?

25 A That's right, excepting the Household

1 Diaries study which we pay a contractor to conduct and
2 have influence over the form of the questions and so
3 on.

4 Q Okay. Could you take a look at pages 31 and
5 32 of your testimony where you discuss the coverage on
6 parcel post? I note you recommend a coverage of 115
7 percent, correct?

8 A Yes.

9 Q Your discussion on 31 and 32 of your
10 rationale for that coverage for parcel post doesn't
11 discuss Criterion 8, the ECSI criterion. Is that
12 correct?

13 A That's correct.

14 Q I'm curious. What consideration did you
15 give to Criterion 8 when you decided to recommend 115
16 percent coverage for parcel post?

17 A The accurate answer is little or none. That
18 coverage is driven by where we start at the beginning
19 of the rate case and some of the rate structure
20 changes. That's too strong a word.

21 Q The other reasons aren't critical to what
22 I'm trying to get at.

23 A Okay. Right.

24 Q Little or none was your answer?

25 A That's right.

1 Q Okay. On page 33 of your testimony where
2 you discuss the rationale for BPM coverage you have
3 this line that we discussed before about over a period
4 of years an increasing numbers of books have been
5 mailed as BPM.

6 The Commission accordingly has given the
7 subclass some ECSI consideration in setting rate
8 levels. The Postal Service proposal maintains that
9 practice. Is that correct?

10 A That's correct.

11 Q I see you said something similar in your
12 discussion of ECSI on page --

13 A In the first part?

14 Q Well, no. When you discuss each criteria.
15 This is in your revised testimony at page 15. There
16 you say "and to some degree bound printed matter." Do
17 you see that, similar language?

18 A Yes.

19 Q Let me try to figure out what that means.
20 Does that mean that because let's say 52 percent of
21 BPM is books that since some of the content is books
22 they get the ECSI consideration, but some of it
23 doesn't? Is that what you mean?

24 A Yes. That would be the basic rationale. I
25 have to say on reviewing this that that's also

1 parallel at least in first class.

2 Some years back the New York State Consumer
3 Advocate -- rough title anyway -- introduced some
4 evidence that certain parts of first class, on the
5 basis of a survey that he or she or they had
6 conducted, were valued by recipients, but I recall the
7 Commission decision saying unfortunately that portion
8 of it was not all that large in first class.

9 So I've never seen numbers attached to how
10 much the coverage was moved, but I think in both
11 cases, unlike the other examples, it is the case that
12 only a portion, well less than 100 percent -- well,
13 less than 75 percent -- is the sort of material which
14 is traditionally recognized as having ECSI value.

15 Q Within first class you wouldn't, for
16 example, give ECSI value to a credit card
17 solicitation?

18 A No.

19 Q An invoice?

20 A No.

21 Q Okay. I just wondered. You don't say to
22 some degree first class letters.

23 A That's right. I was just making the point
24 that there really is a parallel, and I might well have
25 better stated the testimony in those terms.

1 Q Okay. Is it your position that when you say
2 on page 15, "The Postal Service's rate level proposals
3 conform to this practice," that you are attempting to
4 discern the Commission's use of the ECSI criteria and
5 apply it to this case rather than changing the
6 Commission's interpretation of ECSI and the meaning
7 that is given to it?

8 A That's basically correct. It's not so much
9 discerning per se as not ourselves proposing to adjust
10 the coverage on the basis of our rethinking how ECSI
11 should be treated or having evidence that we thought
12 warranted a change on the basis of ECSI
13 considerations.

14 Q Would you agree with me that the last fully
15 litigated omnibus rate case was Docket R2000-1?

16 A R2000-1? Yes.

17 Q Okay. In that case I pulled some numbers,
18 which I would just ask you to accept subject to check.

19 These are pulled from the Commission's
20 opinion recommended decision, Appendix G, which I'm
21 sure you've looked at a few times. It's page 36 in
22 their markups, which I've just converted to coverages
23 to ask this question if that's okay.

24 The coverage on parcel post, and this is
25 Docket R2000-1. The coverage on parcel post was

1 1.15.5 as modified by the governors. Do you remember
2 that in July? Then it was 1.14.9 before modification.

3 A Uh-huh.

4 Q The coverage for BPM was slightly less than
5 parcel post. It was 1.13.1 as modified and 1.13.9
6 before modification.

7 In light of the fact that BPM gets some ECSI
8 consideration, would you consider a coverage for BPM
9 that was slightly less than the coverage for parcel
10 post as was done by the Commission in this docket to
11 be reasonable?

12 A I would have to look at the whole set of
13 coverages to be sure.

14 I see your point that they were nearly equal
15 back then and our proposals are not, but every case
16 involves this balancing of coverages across classes
17 taking into account especially impact on mailers, the
18 rate increases applied by the customers and also
19 anything else that may have caused the cost really to
20 change so I can't go beyond saying I noticed obviously
21 that they were pretty close together then, and now
22 there's a 10 point difference roughly, but I don't
23 know how I would have assessed things back then.

24 It's the Postal Service's proposal. I don't
25 know what considerations quite go to the coverage.

1 It's not necessarily driven by the ECSI value.

2 Q Well, that's not the only factor, I
3 acknowledge, but on the other hand we try to learn and
4 apply principles from prior cases, do we not?

5 A We do, yes.

6 Q And in this case, in R2000-1, the coverage
7 for BPM at least in that docket was below parcel post,
8 correct?

9 A By something around a percentage point.
10 Right.

11 Q Well, before modification it was 1.0. After
12 modification it was 2.4 percent.

13 A After modification it was 1.13?

14 Q After modification, BPM was 1.13.1.

15 A Okay.

16 Q Do you see?

17 A Yes, I see. One percent or one and a half.

18 Q One or 2.4. Those are the numbers. Do you
19 see those?

20 A Yes. Yes, I do. Yes.

21 Q Okay. The recommendation you're making is
22 for the coverage of BPM to be higher than parcel post
23 in this docket, correct?

24 A That's correct.

25 Q Let me ask you about media mail and library

1 mail, which you reference in your ECSI discussion.
2 Now, there is it true that all of the content is
3 presumably entitled ECSI consideration?

4 A I believe so. There's enough different
5 things that are included under both, but in terms of
6 sound recordings and the like that you don't
7 ordinarily think of as book rate, if you will, but
8 they're there and have been for a long time.

9 Yes, I think everything in the class,
10 certainly the class as a whole, is if not 100 percent
11 very nearly 100 percent of what falls under that
12 criteria as I understand it.

13 Q Okay. For BPM we don't really know, but if
14 we use the Postal Service reply brief as our authority
15 we decide that it was about 52 percent that would
16 qualify for ECSI? Is that correct?

17 A Right.

18 Q And for parcel post presumably none or very
19 little would qualify for ECSI. Would that be fair to
20 say?

21 A I guess as far as I know, but I would like
22 to have more information just to see whether, for
23 example, in some categories actually parcel post rates
24 would be cheaper for people sending books, certain
25 weight, zone distances. It shouldn't happen very

1 often, but --

2 Q I'm just trying to compare these three
3 coverages --

4 A Yes.

5 Q -- and the principle we can discern from it
6 because you've got media mail and library mail where
7 all is ECSI and you recommend 1.09, BPM where over
8 half, according to we were discussing this is ECSI and
9 you give it 1.25, and then for parcel post where none
10 of the volume is ECSI you give it 1.15, correct?

11 A Yes.

12 Q Okay. Is there something you can tell us
13 about BPM that has changed since R2000-1 that's caused
14 it to go from 1.0 to 2.4 percent below parcel post to
15 now 12 percent above parcel post?

16 A I cannot tell you anything specifically. I
17 didn't examine so much the changes in coverage,
18 certainly not over the entire period.

19 Q I'm sorry. Excuse me. Before you finish
20 answering, I made a mis-statement. It's 10 points
21 higher because your BPM is 1.25 and parcel post is
22 1.15. I said 12. Excuse me. I meant 10.

23 A Good.

24 Q Go back to your answer.

25 A I don't know what has happened in either

1 class, parcel post or bound printed matter, that has
2 led the coverage to be different.

3 One thing that can change coverages is the
4 difference in growth and cost and desire to mitigate
5 the effects of that, the rate increase effects of
6 that.

7 Q Do you know whether that happened here?

8 A I don't know of any intervening cases. Of
9 course, one of them was across the board. The other
10 one was settled. I don't know.

11 Q Was there a chance that you mitigated the
12 coverage of parcel post in order to mitigate the rate
13 increase?

14 A In this case there is, yes. There are some
15 portions of parcel post that have some rather large
16 increases. That was a consideration.

17 Q Any other guidance you can give us as to how
18 we have this swing from two points below to 10 points
19 above for coverage?

20 A Not specifically. It really is a
21 simultaneous problem that we have to solve as to how
22 the institutional costs should be distributed.

23 Q This was your solution?

24 A This was my solution, yes.

25 Q Thank you.

1 A Not mine alone, of course.

2 Q Of course.

3 A Yes.

4 MR. OLSON: Thank you, Dr. O'Hara.

5 Thank you, Mr. Chairman.

6 CHAIRMAN OMAS: Thank you, Mr. Olson.

7 Mr. Anderson, American Postal Workers Union,

8 AFL-CIO?

9 MR. ANDERSON: The APWU has no questions of
10 Mr. O'Hara at this time.

11 CHAIRMAN OMAS: I beg your pardon?

12 MR. ANDERSON: The APWU has no questions of
13 Mr. O'Hara at this time.

14 CHAIRMAN OMAS: Thank you, Mr. Anderson.

15 Association for Postal Commerce and the
16 Mailing Fulfillment & Services Association, Mr.
17 Volner?

18 MR. STRAUS: Mr. Chairman, do you have
19 Association of Alternate Postal Systems on your list?

20 CHAIRMAN OMAS: Yes, I do.

21 MR. STRAUS: Okay. Thank you.

22 CHAIRMAN OMAS: You're next.

23 MR. STRAUS: Thank you.

24 CHAIRMAN OMAS: Somehow Mr. Volner got in
25 there.

1 MR. STRAUS: The order doesn't worry me.

2 CHAIRMAN OMAS: Seniority.

3 MR. VOLNER: Mr. Straus on some occasions
4 has pointed out that he's been at it almost as long as
5 I have. I don't regard that as significant.

6 CROSS-EXAMINATION

7 BY MR. VOLNER:

8 Q Good morning, Dr. O'Hara. My name is Ian
9 Volner, and I will be examining you very briefly on
10 some of the matters principally related to media
11 services.

12 Could you turn to page 33 of your testimony,
13 please?

14 A Yes. I have it.

15 Q At lines 20 to 21 you say that the proposed
16 cost coverage is 109 percent, and this translates into
17 an average rate increase of 18 percent for media mail.

18 A Yes.

19 Q So that effectively at the cost coverage
20 you've proposed the rate increase for media services
21 is more than double the system average? Is that
22 correct?

23 A Yes.

24 Q Now, Mr. Olson took you through some
25 questions about prior cases, but I have a specific

1 question.

2 In connection with media mail, did you
3 consider the most recent rate increase in setting the
4 cost coverage for media services?

5 A Meaning from the case before?

6 Q Meaning from 2005, yes.

7 A I probably did think about that, but I have
8 no clear recollection of what it was or how it
9 impacted, but we do not only look at the rate
10 increases implied by potential proposed rates, but
11 also by recent rate increases as well, particularly
12 since this one was so close.

13 Q And you look at that particularly in terms
14 of rate shock? Is that one of the reasons?

15 A Yes. Correct.

16 Q Okay. Will you accept subject to check that
17 in the last rate case the increase, although the
18 across the board increase was roughly 5.5 percent, the
19 increase for media services was in excess of 12
20 percent?

21 A Yes.

22 Q So that, assuming that my little calculator
23 worked correctly, in the past two cases -- that is to
24 say what you've proposed here plus what was done in
25 2005 -- media services will experience a 30 percent

1 increase in rates against about a 14 percent system
2 average increase?

3 A Yes.

4 Q Mr. Olson pointed out, and I think you
5 agreed, that media services is pure educational,
6 cultural, scientific and information value.

7 A Yes.

8 Q But there's also now an unusual feature to
9 media services because it is no longer just commercial
10 mail. It also includes, at least in the combined
11 costing, library rate mail.

12 Does that characteristic factor in at all to
13 your evaluation of the ECSI factor in applying to
14 media services?

15 A Well, not any differently than before.
16 There was always a specified rate relationship or
17 coverage relationship between the two, at least going
18 back a good many years, and the way it was originally
19 specified in the law a small what you would call
20 statistical sampling error perhaps in the costing
21 would cause big differences in the rate increase.

22 We thought there was a better way to do it,
23 and everybody managed to agree, customers and
24 Congress. I think that hasn't really changed. It's
25 just implemented the way that gets the same average

1 result we hope and avoids the situation where one part
2 of what's really a very similar group of mail except
3 for the rate consideration would have different rate
4 increases.

5 I really don't think anything there caused a
6 need for any change in the way we look at it.

7 Q Is it your view that Public Law 106-384,
8 which is where the combined cost data phenomenon
9 occurred, resolved the cost issue?

10 A Well, I guess I don't understand. My view
11 of the cost issues is that what I called sampling
12 error was causing things to jump around, not that
13 there was any problem with the costing before or after
14 except that.

15 I don't know that there was a problem
16 before. The problem has been resolved.

17 Q Okay. So it was causing things to jump
18 around. Do you know whether they're still jumping
19 around?

20 A I don't think between media and library they
21 are.

22 Q I see. Between media and library they are
23 not?

24 A Yes.

25 Q Let me ask you directly. Are you familiar

1 with the Commission's discussion of why it did not in
2 the 2005 case accept the 5.5 percent across the board
3 increase in the application to media services/library
4 rate?

5 A Not specifically with respect to that
6 combination of classes. I thought it was all cost
7 driven in anything that deviated from the across the
8 board figure.

9 Q Well, what the Commission said, and I'm
10 reading this, if you'll accept this subject to check,
11 is that the Commission said that the cost fluctuations
12 and the above average increase in media and library
13 rate mail make the recommended 100.2 percent cost
14 coverage reasonable.

15 It went on to say, "The Postal Service is
16 urged to explore why the unit costs for these
17 subclasses continue to fluctuate." Do you know
18 whether any such exploration was conducted?

19 A I'm not aware of anything specifically. The
20 one thing which I guess really might not result in
21 fluctuation but does I think draw a tendency for above
22 average cost increases is the fact that both media and
23 library are unzoned and so since you can send the same
24 material in media in other classes, including bound
25 printed matter, which is zoned, people make a rational

1 decision on short zoned shipments to use bound printed
2 matter.

3 That leaves an increasing proportion of
4 longer origin destination distances and therefore
5 higher costs left to media mail.

6 Q We'll get to the question of cross migration
7 in a few moments, but let's just stay with the
8 Commission's decision.

9 "The Postal Service is urged to explore why
10 the unit costs for these subclasses continue to
11 fluctuate." Do you know whether any cost studies were
12 done or any further analysis was done?

13 A I don't know whether, but that would not
14 normally be something that would necessarily come to
15 my attention.

16 Q I see. That helps. Let me phrase it
17 slightly differently.

18 When Witness Yeh, who was, as you may
19 recall, the rate design witness on media services, was
20 here I asked her whether she had discussed this
21 passage from the Commission's decision with anybody,
22 and she said that she discussed it generally or
23 discussed the Commission's decision generally, but she
24 did not say that she had discussed this particular
25 passage. Did you discuss it with her at all?

1 A I don't think so.

2 Q Okay. Let's turn for a moment, if we can,
3 to page 34 of your testimony, lines 6 and 7.

4 A Maybe I should for the benefit of the
5 record. I think you're referring to the version
6 before August 25?

7 Q Yes. I'm sorry.

8 A Yes. If you want to tell me the line
9 numbers?

10 Q I'm sorry. The sentence says, "...but the
11 rate increases reflect cost increases, and the revenue
12 they generate provides only a small margin above
13 cost."

14 A Okay. Yes. That's lines 9 through 12 on
15 page 34.

16 Q Now, we've discussed the question of cost
17 increases. What I'm interested in now is the question
18 of what you mean by the term "small margin."

19 Are you talking about cost coverage markup,
20 or are you talking about unit contribution?

21 A I don't think I was specifically focused on
22 one as opposed to the other. I believe that statement
23 -- really if you're thinking at the point in time,
24 those are the same thing. You can turn a cost
25 coverage into a unit contribution in terms of cents.

1 Q But the unit contribution is going to depend
2 upon the unit cost, isn't it?

3 A Yes.

4 Q And isn't it typically the case that
5 parcels, because they're heavier probably, have a
6 sometimes larger unit contribution given the same cost
7 coverage as, for example, a letter?

8 A Sure.

9 Q But what I take it you're saying is that
10 when you wrote this particular passage you did not
11 take a look at the effect on the unit contribution
12 from media services mail?

13 A I don't recall doing so.

14 Q All right. Now let's go back to the subject
15 that you opened up for me a few moments ago.

16 You pointed out that there is some cross
17 over between bulk bound printed matter and media
18 service in that some portions of media service may be
19 able to migrate to bound printed matter.

20 That is not true, is it, with respect to,
21 for example, CDs or sound recordings?

22 A That's correct.

23 Q That's because they're not bound?

24 A Right.

25 Q And they're not printed, but they certainly

1 matter to some people?

2 A Yes.

3 Q Okay. Let's take it the other way for a
4 moment. In your testimony and in your discussion with
5 Mr. Olson earlier this morning you pointed out that
6 there is the possibility of migration from bound
7 printed matter to media services.

8 A Yes.

9 Q But that's not universally true, is it,
10 either?

11 A No. I mean, each of those categories have
12 restrictions on what can be mailed.

13 Q Correct. The only thing that could migrate
14 from bound printed matter to media services would be
15 books?

16 A Certainly that's the main case. There may
17 be others, but yes. Sound recordings.

18 Q When you did these kinds of comparisons in
19 your testimony did you make any attempt to figure
20 out -- and I gather the answer to the first part of
21 this question is going to be no because you've already
22 discussed it with Mr. Olson -- what percentage of
23 bound printed matter is in fact a book by definition
24 under what used to be special rate fourth media
25 services?

1 A No. I did not know of any information of
2 that sort.

3 Q Conversely, did you make any attempt to
4 ascertain the current composition of the content of
5 media services?

6 A No.

7 Q So then we don't know how many books, if
8 any, there are that could migrate?

9 A That's correct.

10 Q And so since we don't really know the extent
11 to which migration might occur, what does that do in
12 terms of your evaluation of the fluctuation in cost in
13 media services particularly as the Commission
14 expressed its concern about it?

15 A That's why I a moment ago said that I wasn't
16 sure that my point about migration was really as to
17 fluctuations as opposed to long-term trends so I'm not
18 sure that there's that tight a connection, but I think
19 the trend in the rate relationships over time has been
20 to increase the incentive to use media mail where
21 allowed for long distance trips and use bound printed
22 matter for short distance trips.

23 Q That's a very interesting proposition. Do
24 you know when bound printed matter was opened up to
25 books?

1 A Not exactly, no.

2 Q Would you accept that it's more than 20
3 years ago or roughly 20 years ago?

4 A Sure. Yes.

5 Q Now, you're very experienced and a very,
6 very good economist. Don't you think that to the
7 extent that migration was going to occur it would have
8 already occurred?

9 A Migration that is driven by the rate
10 differences at the time I think would take place
11 pretty quickly, but as that migration first step
12 happens the costs for the next rate case are based on
13 the changed distribution of trip length in response to
14 that, and that tends to drive the media mail cost up
15 more so than the bound printed matter cost, so there's
16 a second potential for migration if those costs are
17 directly translated into rates. It can go on for a
18 long time.

19 Q Without some knowledge of the volume mixes
20 we couldn't really determine that, could we, whether
21 it would continue or not?

22 A The eligibility. Well, you can't be sure
23 exactly how much is constrained by restrictions that
24 would prevent migration for a certain portion of the
25 mail either direction, but unless we are down to no

1 short distance books in bound printed matter -- I'm
2 sorry; no long distance books in bound printed matter
3 -- there's still some potential.

4 I don't really think that we're down to that
5 point yet, but it's hard to know, to have data.

6 Q Let me just finish this line up with one
7 further question.

8 A Yes.

9 Q I think you pointed out under the statute at
10 least as it's read media services cannot have a drop
11 entry discount.

12 A That's right.

13 Q And bound printed matter now does have --

14 A Yes.

15 Q -- a number of drop entry discounts, doesn't
16 it?

17 A Right. Yes.

18 Q Okay.

19 A Which may reinforce the tendency we were
20 talking about in a sense.

21 Q Well, it might also reinforce the tendency
22 to take things out of media services if you can
23 qualify them for bound printed matter so that you can
24 get the requisite densities to achieve the drop entry
25 discounts in bound printed matter.

1 A I have to think that one through before --

2 Q That would be a yes or a no. We're both
3 speculating.

4 A Yes. Well, I'm even trying to see if the
5 arithmetic or the relative magnitude -- it's not
6 actual numbers -- work. I can't come to a conclusion
7 without spending more time on it at this point.

8 Q I think that's fair. In your discussion of
9 the potential for migration did you compare the
10 proposed rates for the two subclasses to see whether
11 there really was a significant opportunity for
12 migration?

13 A I don't recall looking at them in detail.

14 Q Okay. One last question on this line, and
15 then we'll wrap up very quickly.

16 With respect to the 109 percent cost
17 coverage for media services and the 125 percent cost
18 coverage roughly for bound printed matter, did you
19 take the possibility of cross migration into account
20 in setting the coverages?

21 A In setting the coverages that would have --
22 I think if my ideas on migration are still having an
23 effect on relative cost it would have taken place in
24 the rate shock area rather than the --

25 Q Okay.

1 A Indirectly, but not separately.

2 Q One last set of questions. When Witness Yeh
3 was here I think she agreed with me that media
4 services has a somewhat unusual rate structure in the
5 sense that pieces are rounded up to the nearest whole
6 pound, postage pound.

7 A I think that's correct, but I'm not sure
8 about unusual. I mean, we do that in parcel post.

9 Bound printed matter is the one I would call
10 unusual I guess, but maybe that's just a distinction
11 that doesn't really --

12 Q You do that in single piece parcel post,
13 correct?

14 A Definitely, and I may be about to learn
15 something about parcel select, but they are still
16 stated in rate tables, pound or fraction thereof.

17 Q Correct. In setting the markup for parcel
18 post and for media services, did you consider the
19 round up effect of the rate design?

20 A No, I didn't. That's something that's been
21 there for a long time and so I figured to the extent
22 it had an effect there was nothing new. I mean, I
23 didn't even get that explicit in my consideration.

24 Q You applied the markup to the cost, not the
25 revenues obviously?

1 A Yes. Sure.

2 Q Are you aware of the fact that Witness Yeh
3 testified that there were some other things that have
4 been there for a long time like a two cent allowance
5 for certain costs that were added not in the cost
6 analysis, but by the rate design witness?

7 A No, I'm not aware of her testimony as to
8 that.

9 Q So then when you were looking at the costs
10 you were looking at the costs as generated by the
11 costing witness and not anything that was added by the
12 rate design witness?

13 A That's true. Absolutely. I'm a little
14 puzzled by the notion that cost is added to the CRA
15 total reported from the costing side by the rate
16 design witness.

17 It may be that the costs are sliced apart
18 and part of them -- the non-distance related
19 transportation cost or something like that -- is put
20 into a particular part of the rate design, but I don't
21 think the total cost increase between the time the
22 costing people are finished and the time the rate
23 people are finished --

24 Q Well, I want to tell you that I was more
25 than a little bit puzzled, and since I've been looking

1 at this subclass for a number of years now this is the
2 first time I've ever noticed it so it was a little
3 embarrassing to me too.

4 Basically what you're saying is that you
5 applied the markup to the cost as you saw it, that to
6 the extent that there were fluctuations you were using
7 the current costing and did not make any adjustment
8 for the historic fluctuations in the cost of media
9 services?

10 A Except as they would be reflected in the
11 rate shock criteria.

12 MR. VOLNER: Mr. Chairman, I have no further
13 questions. Thank you.

14 CHAIRMAN OMAS: Thank you, Mr. Volner.

15 Mr. Straus? I must apologize. Strictly
16 alphabetically, you should have preceded Mr. Volner.
17 I apologize.

18 MR. STRAUS: Unless you count the "for"
19 ahead of the "of". It depends.

20 CHAIRMAN OMAS: Whatever.

21 MR. STRAUS: I will accept that Mr. Volner
22 is older than I am, but not that he's been at this
23 longer since I was working on putting together the
24 Postal Service case in R71-1. Unless he snuck in the
25 building, he wasn't --

1 CHAIRMAN OMAS: I won't get in between that.

2 You may proceed.

3 CROSS-EXAMINATION

4 BY MR. STRAUS:

5 Q Dr. O'Hara, I'm David Straus for the

6 Association of Alternate Postal Systems.

7 I'm sure that as you can tell from our prior

8 participation in rate cases, we're going to be

9 focusing on Criterion 4 and the ECR saturation rate.

10 Please look at page 12 of your testimony.

11 Now, I have the revised version, the August 25

12 version.

13 A All right. Page 12, yes.

14 Q Looking at the brief paragraph from lines 12

15 to 16, I'm going to be asking you what you mean by

16 some of the words in that paragraph.

17 The second sentence begins, "For mailers,

18 the percentage rate increase..." and it goes on. Why

19 is it that for mailers the percentage rate increase is

20 a useful indicator?

21 A Because mailers are paying the rate

22 increases. I mean, that's true in all cases, all

23 subclasses.

24 For the mailer side of things it's the

25 percentage rate increase relative to other classes and

1 to inflation, and if we look at a particular class
2 getting an increase that is well above either one of
3 those -- I mean, the inflation we can't really control
4 -- it's a question to look and see what's driving it.

5 If it's driven by cost there's not much we
6 can do about it being above inflation or above the
7 other classes.

8 Q Let me go to the end of that sentence then.
9 You say that they are useful indicators; that is, the
10 percentage rate increase relative to the overall rate
11 of inflation and relative to the rate increases of
12 other classes are useful indicators. Indicators of
13 what?

14 A The magnitude of the effect that's likely to
15 occur. I mean, the sentence is about mailers.

16 Q All right. The effect of what on whom?

17 A The sentence is about the effect of rate
18 increases on mailers of the class, the subject of the
19 rate increase or subclass. I would think that would
20 be implicit, but --

21 Q Isn't there also a component of the effect
22 on mailers by the absolute change in the postal rate
23 irrespective of the change in the economy or the rate
24 for other types of mail?

25 A There can be, but we think those things move

1 in opposite directions, and it's easier, especially
2 going across classes, to look at percentages instead
3 of absolutes because 50 cents on an Express Mail rate
4 is not the same as 50 cents on a parcel rate post, a
5 larger percentage of parcel post.

6 Q Clearly. You maybe misunderstood the
7 question.

8 A Okay.

9 Q If there's a mailer of one pound parcels,
10 its entire business is mailing one pound parcels, and
11 that rate goes up 50 cents a parcel isn't that a
12 consideration of impact irrespective of what the rate
13 increase was for other kinds of mail that he doesn't
14 mail and irrespective of the inflation rate in the
15 economy?

16 A Yes. That sort of thing is usually looked
17 at by everybody involved in the overall pattern of the
18 rate case, but more specifically it's looked at and
19 adjusted by the rate design witness.

20 If people above the rate design witness in
21 the hierarchy see something in particular rate cells
22 -- and we do look at them -- that's out of line we
23 inquire why, and maybe there's a reason -- most often
24 cost -- but if not it's often the case that some
25 rethinking is at least done. I don't necessarily say

1 the rate gets changed, but that is a concern.

2 Q That first paragraph on lines 12 through 16,
3 that's discussing the effect of rate increases on
4 mailers?

5 A The last sentence, yes.

6 Q Right. And then the second part begins,
7 "Mailers and private sector competitors...", and then
8 I guess the next sentence beginning on line 17
9 discusses private sector competitors?

10 A Yes.

11 Q Let me read that sentence. "In developing
12 its proposals in this case, the Postal Service has
13 also considered the effect of its proposed rate
14 increases on competitors examining them to avoid
15 unfair price competition." To what does "them" refer?

16 A Proposed rate increases. Yes, proposed rate
17 increases.

18 Q Let's go back to the hypothetical and
19 probably mythical mailer who mails nothing but one
20 pound parcels.

21 Would it be appropriate to consider in
22 assessing the impact of rates on that person the rate
23 for 25 pound parcels?

24 A It's not going to be relevant to him, but
25 the way the rate design in especially a zoned and/or

1 weight dependent rate structure is not something where
2 it makes any sense at all to try and do it cell by
3 cell.

4 You have to have a structure, a process that
5 creates a structure across the various cells of the
6 rate chart, and it's only, as I say, when you see
7 something that somehow is out of line with the rest of
8 them that you may want to take a second look, but it's
9 not always possible to do something like that.

10 In every case we have cells that differ
11 either way from the average for the subclass itself.
12 One can regret that some people are disproportionately
13 affected by it, but I don't think especially even at
14 the rate design level, let alone the rate coverage
15 level, it makes any sense to focus disproportionate
16 attention on the customer who happens to mail only one
17 thing, one cell.

18 There are other customers. You know, if
19 we're going to change this we've got to get the
20 revenue from someplace else. We may be hitting
21 customers who are only mailing some other cells. Just
22 as a practical matter it doesn't seem to me that the
23 way rate design works, as I read the rate effect in
24 Criterion 4, it's aimed at the subclass, not at the
25 cells within the subclass.

1 We look at them, but I don't know that it's
2 any more than trying to understand whether that's a
3 necessary increase or not that sticks out. If the
4 whole subclass is above average then some cells are
5 going to be more above average. Some are going to be
6 less than that.

7 Sometimes it's because transportation costs
8 have changed more than other kinds of costs. You
9 know, there are all kinds of possibilities, so I guess
10 I really can't get much more specific about it.

11 Q Are you done?

12 A I'm done, yes.

13 Q But you did say that when individual rate
14 cells look like they will have a significant impact --
15 I mean, let's take the periodicals, for example.

16 You may recall that the five-digit presort
17 pass through has been well in excess of 100 percent,
18 and the reason for that is that the impact on mailers
19 of five-digit pieces without that would be very
20 severe. Isn't that right?

21 A I don't recall that specifically, but I'll
22 accept it as an example, yes.

23 Q All right. Forgetting about one pound
24 parcels, let's say there are a lot of mailers who mail
25 lightweight parcels. I mean, they don't get into the

1 25 and 30 and 40 pound parcels. They're in the
2 business of mailing out parcels. That's a real
3 situation, isn't it?

4 A (Non-verbal response.)

5 Q Is that a yes?

6 A Yes.

7 Q Okay. If you're considering the impact on
8 those customers, wouldn't you tend to look at the
9 lower end of the weight/rate range in doing that?

10 A Yes. That actually is true of a number of
11 our weight and shape-based classes. We tend to have
12 the volume concentrated in the lower weight cells.

13 That means that if you want to mitigate
14 those rate increases there's not much place to get it
15 out of the heavier cells. There's not much revenue
16 there to draw from, so it constrains us.

17 Q Now let's switch from a mailer to a
18 competitor in the private sector. If a competitor in
19 the private sector raised some concerns about the
20 impact of postal rates and that competitor were a
21 deliverer of lightweight parcels and you wanted to see
22 whether in fact there was any legitimacy to this claim
23 that the Postal Service was perhaps driving it out of
24 business with its rates, would you look at the average
25 parcel rate to determine whether there was any

1 legitimacy?

2 Would you look at the heavyweight parcel
3 rate to determine if there was legitimacy, or would
4 you look at the rates for the lightweight parcels of
5 the kind that this competitor actually delivered?

6 A I guess at the Postal Service side of things
7 we don't have that much information about competitor's
8 rates or the weight levels on which they mainly rely
9 their business is and so we are relying on the other
10 parties and the Commission to weigh such evidence as
11 there is introduced by the competitive industry or
12 firms.

13 What we are able to do is look at the rate
14 increases, more or less as I've specified there, that
15 are relative to other classes. You know, if we're
16 somehow raising first class rates 20 percent and
17 cutting lightweight Priority rates by 10 percent --
18 I'm making an extreme example here -- that would be
19 pretty suspicious.

20 If the rates at the subclass level are not
21 out of line with the pattern of the other rate
22 increases in the case, that's about as far as we
23 really are able to go unless there's something -- you
24 wouldn't want it to have anything that you knew about
25 from say the marketing side of the organization or

1 product management saying boy, we can really take
2 business away from X if we do this.

3 I've never heard that, and I wouldn't want
4 to hear it. I wouldn't want to do rates that do that
5 implicitly.

6 Q Dr. O'Hara, it would be much better if you
7 answer my questions --

8 A Well, okay.

9 Q -- rather than giving a lengthy explanation
10 that goes well beyond anything I've asked.

11 A My answer is -- I should maybe have just
12 stopped at that point -- neither for customers nor for
13 competitors do we really focus on particular sections
14 of the whole range of rate schedules.

15 We get somewhere closer to that with the
16 pass throughs for what is really the bulk of the mail
17 in a particular class, but it's still in the context
18 of a particular rate increase and cost coverage target
19 that we have to be able to balance against the other
20 classes.

21 Q I think somewhere in that answer you said
22 that if you were going to be raising first class rates
23 but lowering rates for lightweight Priority Mail that
24 might deserve a further look. Do you remember saying
25 that?

1 A Yes, I do.

2 Q So in that example then you wouldn't be
3 looking at the Priority Mail rate as a whole. You
4 would be focusing on a section of Priority Mail. I
5 thought that in this most recent answer you said you
6 don't do that.

7 A I say if we had something that was that far
8 out of line it would look suspicious and we would look
9 at it, but ordinarily we do not look at pieces of the
10 rate schedule except as we know how much volume that
11 we already have in those areas, and if you have a lot
12 you can't do much if it's not a lot of the market.

13 You can't do much to those rates because
14 there's nothing else to draw on. You may have a lot
15 of cells, but no revenue in the heavier weight pieces.
16 That's a real situation.

17 Q So I take it then that if, for example, a
18 competitor with Priority Mail were to raise some
19 concerns and it turned out that the Postal Service
20 raised the rates for one portion of Priority Mail but
21 lowered the rates for another portion of Priority Mail
22 your analysis of those concerns wouldn't stop at just
23 the average increase for Priority Mail.

24 You'd also take a look at what was going on
25 within Priority Mail to see whether there were, for

1 example, some big rate increases in certain weight
2 ranges and some big rate decreases in other weight
3 ranges that might in fact have an adverse effect on
4 competition?

5 A Possibly. I really think when we look at
6 those at the rate cell level we are looking at more
7 the rate relationships and the -- there is a desire to
8 have just for explaining things, for communicating
9 with customers, things that don't look sort of jumping
10 around in time, but from cell to cell, one cell
11 getting a big increase and the one next to it getting
12 another, a different percentage increase.

13 We look at the whole thing, but basically to
14 see whether there's a reason for it, whether there's a
15 mechanical rate design process that has led to a
16 result that really doesn't make sense and we need to
17 change the workpapers, if you will, of the rate design
18 process.

19 Q But that examination did not consider the
20 impact on competitors in the private sector of those
21 differences within rate cells?

22 A No, just because we don't know enough to
23 focus on particular cells as they affect customers.

24 Q You conclude at the bottom of page 29 of
25 your testimony, and I'm quoting, "Given the near

1 average rate increase and a cost coverage that exceeds
2 200 percent, this rate increase," meaning for ECR,
3 "does not result in unfair competition for private
4 sector enterprises engaged in the delivery of
5 geographically targeted advertisements and
6 solicitations." Is that right?

7 A That's right.

8 Q So you are able to conclude that because the
9 increase for ECR is about average and the cost
10 coverage seems significant the inquiry is basically at
11 an end?

12 A Yes.

13 Q If instead of the increase proposed here for
14 ECR the Postal Service had proposed no increase for
15 ECR, would that justify further inquiry?

16 A Sure.

17 Q And if the Postal Service proposed say a two
18 or three percent decrease for ECR that would justify
19 further inquiry?

20 A Sure.

21 Q The Postal Service from 1993 through 2000
22 engaged a consultant named SAI to study the alternate
23 delivery industry and provide comprehensive reports,
24 did it not?

25 A It did.

1 Q Did you learn from those reports that the
2 major competition for preprint advertising is in the
3 four, five, six, seven, eight ounce range rather than
4 the minimum per piece range?

5 A I did not. I just have to accept that. I'm
6 not sure I ever read the whole report. It came up in
7 a prior case after all the testimony had been prepared
8 and filed and everything else, and I don't know
9 anyway.

10 Certainly for purposes of discussion I don't
11 dispute that that's the case.

12 Q I'm not asserting that it's the case.

13 A Okay.

14 Q I'm asking. I'm not asking you to accept it
15 subject to check.

16 A No, no. Not subject to check.

17 Q Have you read the SAI reports in the past
18 couple of years?

19 A No. No. I don't think we get any updated
20 reports, as I recall the interrogatory response.

21 Q That's correct.

22 A Yes.

23 Q The response was that it hasn't been done
24 for six years, but my question remains. In
25 preparation of your testimony for this case did you

1 take a look back at say the 2000 report?

2 A No.

3 Q If in fact it's the case that the most
4 common competition with the private sector on
5 alternate delivery of advertising material is in the
6 multiple ounce range because of the economies of scale
7 rather than in the individual single piece range from
8 a competitor's perspective wouldn't the competitor
9 then be looking at his competition at the say four,
10 five, six and above ounce ECR saturation rate?

11 A Uh-huh.

12 Q That was yes?

13 A Yes, naturally. Each, the competitor or
14 customer, looks at the rates that match either what
15 they mail or what their customers, their clients,
16 might consider mailing, so yes.

17 Q With apologies for giving you the numbers 20
18 minutes before the hearing began, I nevertheless did
19 give them to you. Those numbers are my effort to
20 calculate the effect of the proposed rates on
21 saturation ECR pieces with DDU entry with no detached
22 labels.

23 What I suggest to you, the results are that
24 for a four ounce piece the Postal Service has proposed
25 a 2.4 percent increase, not the average 8.9; for a

1 five ounce piece the Postal Service has proposed a
2 half percent increase; for a six ounce piece the
3 Postal Service has proposed a .7 percent rate
4 decrease; and for a 12 ounce piece the Postal Service
5 has proposed a 4.3 percent decrease.

6 Can you either confirm those numbers now, or
7 can you accept them subject to check?

8 A Well, I can't confirm them, but I guess,
9 yes, I'll accept them subject to check.

10 Q They seem about right, though, because of
11 the --

12 A I really don't know them at that level of
13 detail. I couldn't have picked certainly the
14 percentages changes at all.

15 Q No, but by increasing the piece rate and
16 reducing the pound rate you would expect that the
17 result of the increase would be decreasing as weight
18 increased?

19 A The effect of the increase. It wouldn't
20 necessarily go negative, but it appears to have done
21 so in this case.

22 Q You don't know for a fact whether or not the
23 proposed fact would go negative for saturation DDU
24 delivery pieces?

25 A Not for a fact. I'd have to look at the

1 numbers and have done the calculation.

2 Q Isn't that something that's kind of
3 important when the Postal Service puts together a rate
4 filing that it's proposing certain rate decreases?
5 Isn't that something that sort of jumps up at you and
6 comes to your attention?

7 A Well, yes. I'm sure that plenty of people
8 know that.

9 I might have known it at an earlier stage,
10 but I would never have been able to tell you without
11 looking and doing the arithmetic probably that for
12 this particular combination of saturation DDU entries,
13 no DALs, that this pattern of increases turning into
14 decreases would happen. I would expect smaller
15 increases as the weight got heavier.

16 Q There's a lot of mail in the ECR DDU subset,
17 isn't there?

18 A Yes. Sure. That's true.

19 Q About 20 percent of ECR mail weighs more
20 than four ounces, doesn't it?

21 A That one I would have to check.

22 MR. STRAUS: Can I approach the witness and
23 hand him a copy of a response by Postal Service
24 Witness Kiefer to AAPS-T36-7?

25 CHAIRMAN OMAS: Yes.

1 BY MR. STRAUS:

2 Q Do you see, Mr. O'Hara, the witness
3 responded by the percentages in various weight
4 categories?

5 A Yes.

6 Q My arithmetic, if it's as good as it was on
7 the other sheet, shows 19.4 percent of the ECR pieces
8 weigh four ounces or more.

9 A Yes, and 80 percent therefore below.

10 Q Right. If my other numbers were correct,
11 the 20 percent of the ECR pieces or DDU pieces in that
12 group would have rate effects ranging from positive
13 2.4 percent switching over to negative at six ounces
14 and then becoming increasingly negative above six
15 ounces. Is that right?

16 A I think I should just make a point at this
17 stage that the no DAL assumption you've made or rates
18 you've used in making this example makes this
19 consideration only of what happens if people don't use
20 DALs.

21 There's another chunk of the volume -- I
22 don't know how it's split; I don't think we have a
23 very good idea -- that does use DALs, and unless they
24 go to some expense and trouble to change that they're
25 going to get rates -- increases -- higher than there.

1 This is a particular subset of saturation
2 mail that either does not use DALs already or they're
3 going to get these rates. People who do use DALs are
4 going to get higher rates unless they change.

5 Q Who's by far your largest DAL mailer?

6 A It has to be Advo. I don't think that's a
7 secret.

8 Q And it's also not a secret, is it, that Advo
9 has announced that it's going to eliminate DALs?

10 A Uh-huh.

11 Q You said that this is an expensive process.
12 Do you know say on a cost per piece basis over the
13 next three years how much it will cost Advo?

14 A Certainly not.

15 Q Less than the DAL charge presumably, right?

16 A I would think so, yes. Three years might
17 not be the right horizon, but yes.

18 Q So you don't know that it's expensive, do
19 you?

20 A Well, I think if you do the arithmetic. No,
21 I don't know that it's so expensive nobody will do
22 it -- in fact, we hope otherwise -- but I don't know
23 the upper limit.

24 If I were to get their volume and multiply
25 it times the DAL charge you could add it up, but

1 that's all.

2 Q How much is Advo going to spend to convert
3 to an on-piece addressing?

4 A I have no idea.

5 Q Then you don't know if it's expensive or
6 cheap. You said it was expensive. I'm just trying to
7 figure out why you think it's expensive.

8 A Well, it involves expense. I'm not saying
9 it's bank breaking or bankrupting, but it certainly
10 involves expense.

11 Q We're now at the end of this, which is
12 assume we have a group of competitors who compete at
13 the four, five, six ounce level and assuming, subject
14 to check, that the Postal Service is proposing very
15 small increases or even rate reductions for its
16 customers. Do you expect that that would have an
17 adverse impact on those competitors?

18 A It may. I mean, for what I don't know about
19 Advo you can double it about the competitors.

20 This may be something that will make a
21 difference to them. It may be that what they offer
22 and the rates they charge their customers are below
23 the present rate, below the proposed rates after the
24 decrease. I just don't know.

25 All I can do and all I did do was look at

1 the change relative to our average and at the cost
2 coverage, which, as I said, we weren't shaving margins
3 one place to try to pick up business. We do this in
4 the normal course of affairs.

5 Q All you did is compare the average increase
6 for ECR?

7 A Yes. Yes. We looked at the whole, as I
8 said before, but really the concentration for this
9 criterion is on the average increase.

10 Q Isn't that a lot like saying nobody on the
11 Boston Celtics need worry if the average door height
12 in this country is higher than the average person
13 height in this country?

14 A I don't quite think that we're both talking
15 averages, but unless we're going to be in the business
16 of inspecting individual doors or rate cells, I don't
17 see that that really gets us anywhere.

18 MR. STRAUS: Thank you. I have no further
19 questions.

20 CHAIRMAN OMAS: Thank you, Mr. Straus.

21 Mr. Horwood?

22 CROSS-EXAMINATION

23 BY MR. HORWOOD:

24 Q Dr. O'Hara, I'm James Horwood representing
25 the Greeting Card Association.

1 A Yes.

2 Q In your testimony I guess you refer to it
3 several places, but looking at page 18, for example,
4 you refer to price elasticities, and you there talk
5 about the relatively low price elasticities of demand
6 for single piece and workshared first class mail. It
7 was a negative .18 percent for single piece, a
8 negative .13 for workshared.

9 A Correct.

10 Q Did you calculate those price elasticities,
11 or were you using those calculated by Mr. Thress?

12 A That's correct, and it looks like I did not
13 cite to it. Somewhere I have -- maybe it's in the
14 workpapers -- the particular table in his testimony.

15 Q Actually on page 11 of your testimony you
16 have the table.

17 A Yes. Okay. Yes.

18 Q If we assume significantly different price
19 elasticities would your recommendations change?

20 A They could. Once again I hate to repeat
21 this, but if we're going to change one subclass'
22 prices in the direction customers usually desire,
23 which is less increase, we're going to have to
24 increase somebody else's rates more. You have to
25 balance those.

1 Q But the fact that you were looking at what
2 you characterize as relatively low-price elasticities
3 was one of the factors in your recommendation for the
4 first class rates, both single piece and workshared.
5 Is that right?

6 A Yes.

7 Q In this case the Postal Service is for the
8 first time delinking single piece from presort costs
9 for first class mail. Is that right?

10 A (Non-verbal response.)

11 Q But in doing that do you maintain the goal
12 of rate design in first class of obtaining similar
13 unit contributions for the two?

14 A That is something that we are focused on,
15 yes, and the first class pricing witness was directed
16 to try and do in this case.

17 Q And I guess referring to your response to
18 GCA's Interrogatory 31-1 there is a chart that's
19 attached to that, and that chart shows, does it not,
20 that the per piece contributions that you're expecting
21 from the proposed rates are 23.5 cents for single
22 piece and 23.4 cents for presort? Is that right?

23 A I'm going to have to take a minute to find
24 that. Give me the numbers again. Yes, I see it.

25 Q 23.5 cents and 23.4 cents.

1 A Yes.

2 Q In the future, if the Postal Service found
3 that this equality of unit contributions could not be
4 maintained would you consider abandoning the delinking
5 of single piece and presort costs?

6 A I suppose when something becomes untenable,
7 as you posit, you would consider a whole range of
8 options, and that would be one of them, but there
9 might be other things that would be preferable. I
10 just really can't speculate.

11 Q Do you have any sense of the other kinds of
12 things that might be considered?

13 A Well, you can change aspects of the rate
14 design. In fact, we are in this case changing the
15 source of the contribution of cost shapes trying to
16 get the contribution up on the shapes such as parcels
17 within that average or way below average.

18 There might be other such things that would
19 work more through the rate design than to change the
20 target, but it's really hard until you've got a
21 concrete problem to think those things through.

22 Consider it? Certainly, as you pose the
23 question. Do it? We have to look at the other
24 options before we would know what we would do.

25 MR. HORWOOD: Thank you. I have no further

1 questions.

2 CHAIRMAN OMAS: Thank you, Mr. Horwood.

3 Why don't we go ahead and take our morning
4 break now and come back let's say at 11:10.

5 (Whereupon, a short recess was taken.)

6 CHAIRMAN OMAS: Before we begin, Mr. Hollies
7 I think has something to tell us.

8 MR. HOLLIES: Yes. Thank you, Mr. Chairman.

9 CHAIRMAN OMAS: Give us a status report.

10 MR. HOLLIES: I talked to Mr. Reiter during
11 the break about the homework assignment of Witness Yeh
12 and understand that the Commission will see something
13 in writing today on that.

14 In the event that what you see in writing is
15 not a complete or full answer, that pleading filed
16 today will tell you when the rest is coming.

17 CHAIRMAN OMAS: Thank you very much.

18 Mr. Tidwell, you don't have anything to say,
19 do you?

20 MR. TIDWELL: No, Mr. Chairman.

21 CHAIRMAN OMAS: All right. Thank you.

22 With that, Mr. Baker, would you introduce
23 yourself?

24 MR. BAKER: Thank you, Mr. Chairman.

25 William Baker on behalf of the Newspaper Association

1 of America.

2 CROSS-EXAMINATION

3 BY MR. BAKER:

4 Q Good morning, Dr. O'Hara. Could you turn to
5 Exhibit 31B as revised on the 25th of this month?

6 A Got it.

7 Q Am I correct that the numbers that are
8 shaded reflect changed numbers from this table as
9 originally filed?

10 A Yes, that's correct.

11 Q Okay. Does the Postal Service use the term
12 "pricing witness"? Would you consider yourself the
13 pricing witness?

14 A Pricing or price level, yes.

15 Q Okay. That's you? Okay. And your
16 contribution to the process basically appears in
17 Columns 2, 3 and 4, does it not?

18 A Yes. Yes.

19 Q Okay. All right. Now, these revisions here
20 on your testimony as revised on the 25th of August did
21 change the revenue targets and cost coverage targets
22 for a number of the subclasses, did they not?

23 A They changed the numbers that appear on the
24 page because some of the underlying costs changed
25 usually by small percentages, but the numbers -- we

1 try to get them as accurate as we have them by this
2 stage in the process.

3 Q And did some go up and some go down?

4 A Undoubtedly.

5 Q Okay.

6 A Some of the changes were simply reallocating
7 some cost savings to different components. Others
8 though, cost coverage went up because we found that we
9 had not completely accounted for cost savings that the
10 rate witness had assumed were to take place.

11 So if we were going to get the same result
12 with people moving from one category to another, if no
13 cost savings were in there, we better not assume that
14 they actually move. We better charge them the rate
15 before they move.

16 There are a number of things. There's I
17 guess it's a notice accompanying the revisions. They
18 list a half a dozen things on cost and a couple things
19 on -- no. A half a dozen things on the revenue side
20 and two things which affect a lot of the page, but in
21 small amounts, on the cost side.

22 Q And if you would flip to Exhibit 31D?

23 A 31D?

24 Q Yes, as revised also on the 25th.

25 A Yes.

1 Q One can see that except for Express Mail the
2 percentage changes for every class have changed?

3 A Yes.

4 Q I notice that the average rate increase for
5 enhanced carrier route mail and standard is now 8.9
6 percent as opposed to the 8.6 percent as originally
7 filed. Can you offhand explain why that was?

8 A Yes. In the original filing the pricing
9 witness had assumed that the DAL charge would induce I
10 think it was 50 percent of current DAL users to switch
11 to addresses or labels on the piece.

12 But it was discovered probably by one of our
13 Intervenorors that there had been no offsetting
14 assumption, no parallel assumption made on the costing
15 side so we were getting less revenue because we had
16 assumed people would shift, but no cost savings.

17 In order to make things align on cost and
18 revenue, the easiest thing to do was to move the
19 pieces back to being DAL users in ECR, so everybody
20 that was originally assumed to use DALs -- I'm not
21 sure exactly of that number, the basis for it.

22 Anyway, the revision is simply we're getting
23 more revenue from DALs, and that raises the --

24 Q All right. Witness Kiefer's changed
25 assumption about the conversion of DAL account for

1 most, if not all, of that?

2 A That's right. Certainly most. That's got
3 to be the component.

4 Q And similarly if we turn back to 31B,
5 Exhibit 31B, and compare the revenue in Column 2, test
6 year after rates revenue, with the corresponding
7 number in the testimony as filed the increase of about
8 \$32 or \$33 million by my count would have the same
9 cost?

10 A Primarily from that, yes.

11 Q Okay. When did you determine what I'll call
12 the test year average rate revenues that are presented
13 in this revised testimony? It was some point after
14 the case was filed.

15 A The particular digits, yes. I should say
16 that a lot of the shading on the revenue of the very
17 small dollar amounts comes from some changes in the
18 distribution of revenue across classes.

19 That's in my opinion an unnecessarily
20 complex process we have for doing that. You change
21 one thing and it affects everything else, but there's
22 very little dollars attached to it.

23 Q My understanding of the process is when the
24 case is being prepared you set a revenue target for
25 the subclass and that information is then given to the

1 rate design witnesses.

2 It sounds like the process that led to this
3 revised table almost went the other way in some sense;
4 that changes were made by rate design witnesses at
5 least in some places that feed back to you. Is that a
6 fair characterization?

7 A Well, it is just because once the case is
8 filed, especially in the ECR case, we discovered that
9 we hadn't got the cost and the revenue pieces based on
10 the same assumptions and so, as I said, we could have
11 gone either way in making the adjustment, but it's
12 more time consuming and more internal work to do it on
13 the cost side.

14 Q Do you know if the rate design witnesses
15 have seen these new numbers?

16 A Yes.

17 Q Do you know if their proposed rates would
18 meet the subclass revenue targets presented?

19 A Yes. They actually give me back the
20 revenues, so each of the revenues in here that was not
21 affected by the redistribution of special service
22 fees, which I keep saying is small, were actually
23 calculated by the witnesses themselves. I'm able to
24 add the fees on myself if that's all that's changed.

25 Q All right. So then when the Commission

1 recommends rates at the end of this process it's the
2 revenues appearing in Column 2 here that you and the
3 Postal Service want them to obtain from each of the
4 subclasses? Is that correct?

5 A That's as close to correct as we can be. I
6 mean, if we had known everything we know today there
7 would probably be a few changes.

8 The net effect of all the changes together
9 is to add about \$160 million to the net income.
10 That's within the range of a little over two-tenths of
11 a percent of the revenue, and it's within the range of
12 the percentage terms that we've done before, but when
13 we actually filed it was down much smaller than that.

14 Q So put another way, if there is a difference
15 between the revenue totals that a rate design witness
16 has in their initially filed testimony as the record
17 now stands, you want the Commission to use the more
18 current number?

19 A I guess I have to leave that to the
20 Commission.

21 What we are really bound to in the Postal
22 Service filing are the rates themselves. If they
23 generate a little more revenue it might cause some
24 adjustments if we do it over again.

25 It might cause the Commission to make some

1 adjustments, but fundamentally it's the rates that we
2 propose, and we try to demonstrate how they affect the
3 finances and that they come close to break even.

4 I would say that they still do, but not as
5 close as we were originally, which was luck. We were
6 under \$1 million I think from pure break even. You
7 can't do that by skill alone. You could do it with
8 many iterations, but that takes time too.

9 Q Did you say that it's the rates you propose
10 rather than the total revenue requirement that's more
11 important?

12 A Well, it's the rates, and I take the total
13 revenue requirement not to have changed substantially.
14 That two-tenths of a percent is the difference.

15 Q All right.

16 A I don't think there's really anything
17 material there, but it is different, and we
18 acknowledge that it will generate more revenue. The
19 proposed rates will generate more revenue than we
20 initially expected them to.

21 We in the case of the DALs had expected
22 already to have the cost that corresponded to these
23 revenues.

24 Q All right. You were asked by ABA/NAPM an
25 interrogatory, and then yesterday you filed Valpak-9

1 in which it seems that you prefer the table in
2 Valpak-9 to the one you used in NAPM, so let's turn to
3 Valpak-9.

4 A Yes. Exactly.

5 Q You have an attachment to that. We can use
6 your alternative table, which is page 2 of 3 --

7 A Okay.

8 Q -- for my questions, the line of questions I
9 have here.

10 I guess to back up, the ABA and NAPM
11 originally had asked you to present some cost coverage
12 comparisons over time.

13 A Yes. They had attached to their
14 interrogatory a table, which I believe is exactly
15 reproduced, the numbers, on page 1.

16 Q Right.

17 A They asked me to confirm them, and I had
18 filed an initial response to that interrogatory which
19 really didn't completely confirm or explicitly
20 confirm. Then they asked me, of course, to supply
21 direct numbers if I can't confirm them. Well, I
22 looked at a couple of the columns and saw that it
23 appeared that there was a bit of an apples-to-apples
24 problem there, and I suggested some changes, but, for
25 the most part -- I did not, at that point, take the

1 time to go and try to decide for each number on the
2 page whether I could confirm it or not.

3 Q All right. Let's look at page 203 in your
4 response to Val-Pack 9 because that's the alternative
5 table that you prepared.

6 A Yes.

7 Q And I notice that the second column is
8 "system-wide average," and that is numbers drawn from
9 the Postal Service's figures. Correct?

10 A Yes, all of the numbers on this page.

11 Q All right. And I noticed that the test year
12 after rates is now 189 percent, and that reflects the
13 adjustments we've discussed already.

14 As I go down the list from 1994 to 2008,
15 after rates, would you agree with me there seems to be
16 a gradually increasing trend in the system-wide
17 average cost coverage?

18 A Yes. The dotted line across the table
19 between '96 and '97 is a demarcation between the time
20 that the Postal Service used a costing methodology
21 that was very close to what the Commission used --
22 there were a few points of disagreement, I think -- to
23 a methodology that tried to estimate the volume
24 variabilities, especially in mail processing, and
25 wound up with lower variabilities that the Commission

1 used which were based, at least in part, on assumption
2 rather than statistics, which is not always worse.

3 Anyway, so there is a break there, but from
4 '97 forward, I think, although it's not as dramatic,
5 you can say that there is an upward trend, and that
6 has something, as I deal with in the first part of my
7 testimony, to do with some shifts in the degree to
8 which mail is work shared. Mailers have taken costs
9 out of the volume variable side but not out of the
10 institutional side.

11 Q Well, you've gone ahead and answered my next
12 question, which was why, and you listed two reasons.
13 One is the Postal Service's preferred methodology for
14 attributing mail processing costs, and the second is
15 perhaps greater work sharing. Would the escrow
16 requirement be part of that? If you don't know --

17 A I don't know offhand. I don't know how the
18 escrow requirement -- I know it's there, but I don't
19 know how we're treating it. The revenue requirement
20 witness would be --

21 Q Well, I want to focus on the trend here.
22 Does this trend of the proportion of attributable
23 costs declining over time with the proportion of the
24 costs that are institutional increasing over time
25 create any particular problems for the price level

1 witness?

2 A I don't really think so, but there is -- I
3 can design the rates satisfactorily -- knowing that
4 that trend is understandable, but I think there is, in
5 the mailing community, at least parts of it, the
6 belief that not only as work sharing increases should
7 the rates reflect the value of the work sharing, but
8 it also should make the cost coverage go down as well,
9 either over time or between subclasses. The
10 arithmetic won't let you do that.

11 Q Well, as a price level witness, do you have
12 a preference whether you have a larger or a smaller
13 pool of institutional costs to assign?

14 A No, no.

15 Q The larger the pool of institutional costs,
16 does it necessarily follow that the more the rates are
17 going to vary from volume variable costs in order to
18 meet revenue requirements?

19 A Yes. Each -- has to be higher.

20 Q And from an economic point of view, is that
21 somewhat undesirable?

22 A Not to my --

23 Q In the sense that price should ideally equal
24 marginal costs, and the further you get from marginal
25 costs, it's a little less --

1 A We can't price at marginal costs. That
2 would be pressing volume variable costs, which leaves
3 us some tens of millions of dollars below break even.

4 Q And you have to sit through days like today
5 when mailers complain about the cost coverage.

6 A Right. If we could break even by charging
7 marginal costs, we would all be out of our particular
8 jobs anyhow.

9 Q In the bottom part of the table on the
10 bottom of the page, on page 2, of your attachment to
11 your answer to Val-Pack 9, you were asked, and you now
12 present here, a comparison of a couple of combinations
13 of first-class letters and standard mail to a system-
14 wide average, and taking a look at the first-class
15 letters total column, where the test year after rates
16 figure is 1.21, is that a unit of something? What's
17 the unit?

18 A If you go back up to the last line of the
19 top of the panel, if I divide 229 percent by 189, I
20 get 1.21.

21 Q Do you use markup indices in your testimony?

22 A I don't.

23 Q Okay. Are you familiar with the
24 Commission's use of markup indices?

25 A Yes.

1 Q Is this 1.21 figure here a markup index, or
2 is it something else?

3 A I think that would be more properly termed a
4 "cost coverage index," and it's with respect to the
5 system-wide average of this case, not to some prior
6 case, which is, I think, the usual context in which
7 people look at either kind of index.

8 Q Okay. In your response to subpart F of Val-
9 Pack 9, and the question Val-Pack had asked you was
10 they had asked you to explain the extent to which you
11 believe significance attaches to the behavior over
12 time of each of the ratios in the compared-to-average
13 column. In your answer, you state that the ratios
14 don't speak for themselves, and no general conclusion
15 with respect to its significance is possible.

16 A In my view. Right.

17 Q Can you elaborate on why you don't think any
18 significance can be read into these numbers?

19 A Specifically, the trends over time. In any
20 given year, they are just another way of stating the
21 cost coverages relative to the system average.

22 Q Can any conclusions be made of a trend over
23 time?

24 A I don't think there is anything obvious that
25 you can say just from looking at the tables. There is

1 a question if you start after 1996, the trends are not
2 as pronounced, but there is a trend for the cost
3 coverage on single pieces right around one, relative
4 to the system average; cost coverage on presort has
5 tended to increase relative to the system average.

6 I would explain most of that by a greater
7 depth of work sharing and presort and really no change
8 in single piece. That's the nature of single piece.
9 That's one interpretation. I don't think that that's
10 the only thing that some other person might see in
11 those data.

12 Q The checked line between 1996 and 1997; do
13 you know which year the effect of the mail
14 reclassification case of MC95-1 would have appeared in
15 this table?

16 A Those rates went into effect --

17 Q -- June or July of '96.

18 A -- July of '96, I believe, early July. So
19 they would be a little bit even before the line.

20 Q But mostly 1997 on down.

21 A Yes. Nonprofit, standard, and periodicals
22 were a little later, but, yes, basically from '97.

23 Q And so I'm looking now over at the column on
24 the far right, which is the combined ECR and nonprofit
25 ECR where, in 1997, a cost coverage comparison to the

1 system-wide average was a ratio of 1.3; test year
2 after rates, it's 1.14. Do those numbers seem to be
3 trending slowly downward?

4 A The numbers certainly do, yes.

5 Q Would that indicate that ECR's relative
6 share of the institutional cost burden has been
7 declining over time relative to the system-wide
8 average?

9 A There are a couple of arithmetic steps
10 between the table and that conclusion. I'm not sure
11 that the numbers would work that way.

12 Q Can you say why not?

13 A None of these numbers -- well, maybe they
14 did work that way. Let me just take a moment. The
15 system-wide average number in the left does reflect
16 the proportion of institutional-to-volume variable at
17 each point in time, and that has gone up. And if
18 nothing had changed, the costs of the mail groups
19 represented on the table, everything would be the same
20 as it was in 1997.

21 So the fact that the standard ECR tends to
22 decline, I think, does say that the share has
23 declined, as has -- all the way at the bottom is the
24 proposal. So, yes, I think I can agree with this
25 thought, with your suggestion.

1 Q Okay. I want to switch gears and just ask
2 sort of a broader picture here. First-class mail; do
3 you consider that to be a mature product?

4 A That's a concept that I don't claim to have
5 any real knowledge about, but since the total volume
6 is not growing, indeed, declining, that might be a
7 sign of maturity.

8 Q Do you regard first-class mail as a
9 declining product?

10 A I certainly am on the optimistic end of the
11 spectrum on what I expect to happen with first-class
12 mail. I think the decline, if it continues, will
13 continue to be slow. I think there are lots of things
14 that first-class mail provides to mailers that are not
15 yet, at least, available in the same combination from
16 any substitute, but forecasting is not my game, so
17 that's my opinion. Certainly, it does look like the
18 growth rate for standard has been above that for first
19 class for some time.

20 Q First-class mail is no longer a majority of
21 the mail stream, is it?

22 A In terms of pieces, that's correct.

23 Q Is it still the largest?

24 A Still the largest --

25 Q By volume.

1 A No. The standard is largest. My
2 qualification was that we also care about revenue, and
3 the revenue is roughly \$35 billion for total first
4 class and 21, almost 22, for standard, projected.
5 That's before rates, but the relative -- will be about
6 the same.

7 Q As a price level witness, are you concerned
8 that first-class mail is flattening and declining, but
9 it still is giving you the majority of the
10 institutional costs?

11 A I guess I would say not as a price level
12 witness but as just somebody interested in the future
13 of the Postal Service, I do think about those things.
14 Each case is sort of at a point in time. We have a
15 given set of costs. We have a set of rates and
16 revenues before rates, and we need to come up with a
17 new set of rates and revenues that meet the break-even
18 constraint and also satisfy the pricing criteria.

19 That seems to have, even with the special
20 nature of the -- cases, it did not cause problems at
21 this point. There was something that -- we could go
22 through a regular, pretty much routine set of steps
23 and not have to say, "Oh, wait a minute. We're in big
24 trouble here," because the first-class volume is not
25 going, and standard is.

1 I'm not sure what effect, if any -- I really
2 can't identify any that it has on my role as a price
3 level witness.

4 Q Do you have any information or belief on how
5 much longer first-class mail will be able to carry the
6 majority of the institutional cost burden?

7 A Right now, it's carrying -- what I really
8 think is that any change will be gradual. I haven't
9 done any kind of calculations to figure out when it
10 might fall below some relationship to the total,
11 whether it's below half or below the current level.
12 I'm not sure what's happened in the last couple of
13 years, whether it changed its proportion. It looks
14 like, over time, it, over the whole '97 forward
15 period, probably has.

16 I guess I don't expect dramatic changes, and
17 I think first class has a substantial future ahead of
18 it. Part of that is just my opinion as opposed to the
19 Postal Service's view. I don't know anybody that
20 says, "Oh, dear. We've got to do something about the
21 way we cover institutional cost because we're about to
22 go over the edge of cost in terms of first class
23 contribution."

24 Q You say it's your view, but you're
25 testifying for the Postal Service --

1 A Yes. That's why I --

2 Q -- so, in that sense, are you reflecting the
3 institutional view of the Postal Service?

4 A Well, I wanted to make the qualification
5 because of the things that I referred to as going on
6 gradually. Those are my personal views, definitely.
7 I don't think I'm in conflict with anything. I don't
8 really think the Postal Service has announced, not
9 exactly policy but forecasts, I guess, about that. So
10 that's why I made the statement. Some of those things
11 I responded with are not Postal Service necessarily;
12 they are mine.

13 Q Does the Postal Service expect it will need
14 to start getting increased contributions from other
15 classes of mail in the future?

16 A Well, there are ways to get increased
17 contribution to cover institutional cost without doing
18 that. Arithmetically, at least, you can raise the
19 coverage on first class so you get the same percentage
20 of institution cost.

21 Q But if it's a declining class, at some
22 point, you can't do that anymore.

23 A At some point, yes. So I think we're not
24 close enough to that bridge to have put a lot of
25 thought into it. I agree with the principle.

1 Q Do the Postal Service's rate proposals in
2 this case move at all in the direction of setting the
3 stage for getting more of the cost coverage for the
4 institutional cost burden from other classes of mail?

5 A It may happen that that's the result, but it
6 wasn't a --

7 Q Not a stated --

8 A -- not a stated goal.

9 Q I want to talk a little bit about value of
10 service. In July, the General Accountability Office
11 issued a report entitled "U.S. Postal Service Delivery
12 Performance Standards Measurement and Reporting Needed
13 Improvement." Are you familiar with that report?

14 A I mostly am familiar with the existence and
15 maybe a one-paragraph summary. I haven't read it.

16 Q You have not read it.

17 A No.

18 Q Okay. And the GAO report concludes, at one
19 point, that the Postal Service measures whether it
20 meets the service standard or not for only 20 percent
21 or less of the mail stream. Are you familiar with
22 that assertion?

23 A I'm not familiar with the assertion, and the
24 number sounds way too low. Single-piece, first class
25 alone is more than -- I never have all of the numbers

1 on one page, it seems -- that is very definitely
2 measured. So I think that the number seems low, but I
3 haven't even read the number before.

4 Q Well, I'm not going to go into the report if
5 you haven't read it.

6 The report also concludes that the service
7 standards the Postal Service has sometimes are
8 outdated or haven't been updated for a number of
9 years. Are you familiar with that?

10 A Well, I know that the table that was
11 attached to the filing -- I believe it's 54-point-
12 something, which, I think, was attached to one of my
13 interrogatory responses, hasn't changed. That is a
14 table with a checkerboard layout, and some blocks are
15 colored in, and some aren't. It's not a very precise
16 or detailed statement.

17 Q Well, in your response to NAA-8 -- let's
18 just focus on that --

19 A Okay. Let me just take a minute to find it.
20 Yes.

21 Q Have you had a chance to review it?

22 A Yes.

23 Q All right. About halfway through the
24 answer, you state, "There are no service performance
25 measures for periodicals."

1 A Right.

2 Q And just below that: "There are no service
3 performance measures for standard mail."

4 A Uh-huh.

5 Q And I think it was in Val-Pack 7 that there
6 is no nationally representative data on standard mail
7 performance relative to the service standard.

8 My question is this: Did you make any
9 assumptions at all in your testimony about service
10 performance for periodicals and standard mail?

11 A The assumptions that were made essentially
12 was that there were no significant changes in either
13 of those areas. I know that an increasing focus has
14 been put on service for the last five years in
15 general, starting with overnight first class a few
16 years before that. So I would expect that there might
17 have been some improvement, but it's not measured,
18 hasn't been measured, and so there is really no basis
19 for having anything other than an opinion.

20 Q So you don't assume that 100 percent of
21 periodicals and standard mail meets the public service
22 standards for --

23 A No. A hundred percent of first class,
24 even -- first class, doesn't meet --

25 Q Do you assume that the Postal Service meets

1 the service standards for periodicals and standard
2 mail at the same rate as it does for first-class mail?

3 A I doubt that.

4 Q Okay.

5 A There are lots of differences between the
6 checkerboard priority for dispatch and delivery. The
7 table suggests that the standard is at the bottom, and
8 first class is close to the top. So I wouldn't
9 expect, even though the standards are also different
10 for -- the service standard for standard mail is not
11 at all like the service standard for first-class mail.
12 I would be surprised if all of the service standards
13 were met 95 percent of the time.

14 Q Do you happen to recall the service standard
15 for standard mail offhand?

16 A It extends over a period of time, which is
17 not clear from that chart. It's just the Rule 54-N.
18 So some mail is supposed to be delivered by the third
19 day, and other mail -- this depends on entry relative
20 to destination -- goes out to the tenth day.

21 Q Three to ten days.

22 A Yes.

23 Q I just want to pin this down, so let's talk
24 about periodicals mail for a second. Does your
25 testimony and your recommendation in this case make no

1 assumption about service performance for periodicals,
2 or does it assume that the Postal Service
3 underachieves to some unknown amount?

4 A No. I make that assumption, (a) the degree
5 of underachievement for periodicals, package services,
6 and standard has not changed significantly so as to
7 call for a reexamination of coverages on that account,
8 and I also think that an assumption that they are not
9 achieved 100 percent of the time is entirely plausible
10 to anybody that has familiarity with that.

11 On the other hand, I know that for all of
12 those classes, periodicals and standard both -- put
13 some effort into tracking the service they get and
14 trying to figure out why and contacting the Postal
15 Service to see what can be done about it when they are
16 getting service that is below standard or below what
17 they are used to getting. They monitor both. So
18 there is some monitoring going on, but it's not
19 something that is systematic and not by us.

20 Q So is it fair to summarize what you just
21 said is your assumption is that actual service for
22 periodicals mail is worse than the service standards,
23 but you don't know how much worse it is? It hasn't
24 gotten measurably worse than it was before, but you
25 don't know how bad it was.

1 A That's correct. Actual service for every
2 class of mail is at least a little below standard.
3 None of our numbers are 100 percent. I don't know,
4 given the rather wide range of service for standard,
5 how much of that is --

6 Q -- how much is worse. Some of it is better,
7 isn't it?

8 A Yes.

9 Q Standard mail that's entered near the
10 delivery unit is going to get better than three-day
11 delivery.

12 A That's right, yes.

13 Q Okay.

14 A That's right.

15 Q I wanted to follow up -- the last line here
16 is to follow up briefly on some questions asked you by
17 counsel for AAPS, and he asked about -- in one of your
18 answers to him, you discussed DAL pieces, and some of
19 saturation mail will be converting from DALs or not,
20 although the formal assumption in the case is it
21 won't.

22 A Right. That particular assumption is
23 because it's also assumed on the cost side that there
24 won't be any savings. Originally, we did expect, and
25 I think, in reality, do expect, people to make the

1 change, not take the surcharge, and create some cost
2 savings.

3 Q Some people will make the change.

4 A Yes. Right.

5 Q Do you expect some people won't?

6 A Right.

7 Q Do you know what percentage of ECR mail uses
8 DALs today?

9 A I don't. There may be some other testimony.

10 Q There was. Mr. Kiefer had it, or Mr. Kelley
11 and Mr. Kiefer presented data on that. Would it
12 surprise you if the number was less than 50 percent?

13 A Not particularly.

14 Q Okay. For members of my client, newspapers
15 that might mail TMC programs, some of them mail at
16 saturation rates, but those of them that mail at high-
17 density rates, they use on-piece addressing already.
18 So high-density mailers have incurred -- whatever
19 expense of on-piece addressing, they have already
20 incurred it.

21 A Yeah.

22 Q Okay. They seem to have managed okay.

23 A True.

24 MR. BAKER: Mr. Chairman, I have no more
25 questions.

1 CHAIRMAN OMAS: Thank you, Mr. Baker.

2 It's sort of a little bit before 12 o'clock,
3 and I'm just wondering. We have three more witnesses
4 to go, and I didn't know how long -- should we
5 continue and finish?

6 Ms. Dreifuss, about how long is your cross?

7 MS. DREIFUSS: I would say about a half an
8 hour.

9 CHAIRMAN OMAS: Half an hour? Mr. McKeever?

10 MR. McKEEVER: About 10 to 15 minutes.

11 CHAIRMAN OMAS: Mr. Olson?

12 MR. OLSON: Thirty minutes.

13 CHAIRMAN OMAS: Okay. Well, then why don't
14 we just go ahead and break for lunch and come back,
15 and we can be refreshed, and Mr. O'Hara can be
16 refreshed. Why don't we come back at 1 o'clock?
17 Thank you.

18 (Whereupon, at 11:54 a.m., a luncheon recess
19 was taken.)

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1 Q At page 9 of your testimony, you start to
2 discuss Factor No. 2, value of service, and I would
3 like to place emphasis on two of the words that appear
4 at lines 27 and 28 of your testimony at page 9. Turn
5 to page 9 of your testimony .

6 A Right. Okay.

7 Q I'm going to look at lines 27 and 28.

8 A Okay.

9 Q You state that Subsection 3622(b)(2) refers
10 to the value of the mail service actually provided to
11 both the sender and the recipient, and it's those
12 words "actually provided" that I would like to focus
13 on for now.

14 Have you discussed, to any appreciable
15 degree, the value of service actually provided to
16 mailers in your testimony?

17 A Not at length. I've had a few
18 interrogatories basically on the existence of measures
19 of service actually provided for certain classes of
20 mail, such as standard, and the fact is that we don't
21 have such measures.

22 Q I see. So you would agree that the Postal
23 Service generally does not have such measures.

24 A Correct. We have sort of built into the
25 product a measure, at least, of delivery time for

1 express mail, and we have explicit systems for first-
2 class mail and priority, but beyond that, it's
3 partial, and I think what is now posted on the
4 Commission Web site, in response to the OCA's request
5 in the previous case, for retail parcel post -- I
6 believe it is -- is based on scanning delivery
7 confirmation or other bar coded labels from single-
8 piece entry to scan of delivery.

9 So there is that little piece of it which I
10 think is important and could be done from operational
11 processes. It's not like the XFC where we have
12 somebody depositing pieces specifically for measure
13 how long it takes to get to the destination.

14 Q Counsel for NAA introduced the subject of a
15 GAO report with you. Do you recall that?

16 A Yes.

17 Q The report number -- you don't need to know
18 this, but for the record, the report number is GAO06-
19 733.

20 When you were discussing it with Mr. Baker,
21 you expressed some surprise, and perhaps maybe you
22 were even disagreeing with the notion, that most mail,
23 the vast majority of mail, does not have its
24 performance measured. Did I understand your reaction
25 to his question --

1 A The question, as I recall it, was, quoting
2 from the report, or at least describing it from the
3 GAO report, that less than 20 percent was measured,
4 and I thought, certainly single-piece mail and
5 priority are, at least together, more than that. We
6 do have pretty good measurement systems there. So I
7 was just surprised at the number, but I'm not
8 surprised at the idea that there is a big chunk of
9 mail that we don't measure, no doubt about that.

10 Q Let me give you some of the specific numbers
11 from the GAO report, and I think you'll probably see
12 that he was very close to giving you the correct
13 figure.

14 This is a highlights page in the report. It
15 seems to be the page that immediately follows the
16 title page. There is a chart here, and in that chart
17 GAO lays out the major classes of mail and the volume
18 of mail that's measured. They start out with standard
19 mail, and they say standard mail is 48 percent of
20 total postal volume. Does that sound about right to
21 you?

22 A Yes.

23 Q And they say that none of it is measured.
24 Does that also sound right to you?

25 A Yes, relative to performance standards.

1 Q Okay. The next type of mail that they list
2 is first-class bulk mail, and they say that that
3 comprises about 25 percent of postal volume. Does
4 that sound about right to you?

5 A It's close anyway.

6 Q Okay. And they say that none of that is
7 measured either. Does that sound right?

8 A I know it's not measured in the XFC. I
9 don't know if we have any real system -- but I know
10 mailers, and, I think, the Postal Service as well,
11 because we have had to discuss things across the
12 table, from confirm has some on that. There is no way
13 to know. It depends on the customer
14 putting the confirm code on the piece, so it's hard to
15 get a representative projectable measure of national
16 performance, but I think, from a customer-relations
17 point of view and an operational point of view, there
18 is useful information generated to know what's
19 actually happening, and it may not be the customers
20 behind the service standards; it's just how long did
21 it take, and if it took three days, why is your
22 standard only two? But I think that's not the main
23 customer attitude. They want consistency, and they
24 want something that's close to what we say, and they
25 want consistency from day to day.

1 So I think there is something there, but
2 it's not published, and it's probably not, as I said,
3 statistically projectable. I think, from the sender's
4 point of view, there is information that is useful.
5 That's as much as I know.

6 Q While it's not statistically representative,
7 would you think that the more participation, in terms
8 of the number of pieces that have planet codes applied
9 to them and use the confirm service, that one would
10 start to approach representativeness by increasing the
11 number of pieces that are involved with confirm?

12 A If you've got close to 100 percent, I think
13 that would be the case. Much below that, I think
14 there would be maybe as big a statistical problem as
15 with whatever the number is today, but I'm not really
16 able to judge that. But more numbers, more
17 observations, not necessarily that much more
18 information, especially when you don't know the
19 characteristics of the mail, whether most of the mail
20 you're measuring is from credit card companies, who
21 tend to mail across country, or from local utilities.
22 You have to have some idea of the representation
23 across the relevant dimensions, whatever the distance
24 and so on.

25 So it couldn't hurt, but I'm not sure that -

1 - project lots of different things nationwide on a
2 thousand people, citizen interview. If you want a
3 national number, a thousand people is enough. If you
4 want a state number, a thousand people is enough. You
5 reach diminishing returns with statistically drawn
6 samples pretty fast, and, in this case, we don't know
7 what the sample represents.

8 So I would not want to give people the idea
9 that all we need is to push the number up a fair
10 amount -- I don't even have an idea what the base
11 number is, but knowing what part of the mail is
12 represented by what fraction of the scans is maybe a
13 bigger deficiency than the number of scans we get.

14 Q I don't recall offhand the number of pieces
15 that had confirm applied myself. I'll throw out one.
16 I think it's plausible, but let's not worry about
17 that.

18 Let's say, right now, the level of usage of
19 confirm for this past fiscal year was about a billion
20 pieces carried planet codes and could be tracked
21 through confirm.

22 A Right.

23 Q Would you say, if that number could be
24 increased to 20 billion pieces, that it might be an
25 even more valuable source of information on --

1 A The direction is clear, but a billion is
2 already a lot of pieces. It's way more than we have
3 in the XFC. So I think it may be the case that
4 getting better information about the source might be
5 more productive than trying to multiple by 20 times,
6 if that was the hypothesis.

7 Q So if it's as much as a billion, do you
8 think it could be a rich source of information to the
9 Postal Service?

10 A If we had the basis -- we knew which portion
11 of it represented what, whatever stratification you
12 would want to use -- I haven't thought that through,
13 but certainly industry -- I just don't want to
14 speculate. I think that might be the most fruitful
15 approach rather than trying to push it from one to two
16 or one to 20.

17 Q When I said that GAO concluded that first-
18 class bulk mail was generally not measured, you used
19 confirm as an example of how the Postal Service does
20 have some information about mail.

21 A Yes.

22 Q Now, I cross-examined Mr. Mitchum. He is a
23 confirm witness for the Postal Service.

24 A Yes, confirm pricing witness.

25 Q Confirm pricing witness. That's right.

1 Now, the Postal Service is free -- I don't think we'll
2 have the time to do it right now -- maybe by redirect
3 they will, but my recollection of what Mr. Mitchum
4 told me is that the Postal Service attaches no value
5 at all to the application of planet codes in the
6 confirm service by its customers, that the only value
7 it sees in planet codes is when it seeds the mail
8 itself.

9 Let me take it a step further. My
10 understanding, or my recollection, of what he told me
11 was that managers actually don't look at the movement
12 of these confirm pieces unless a mailer brings it to
13 their attention. So, assuming that that's true, then
14 I think --

15 A I could make the assumption, but I'm not
16 sure that I'm in a position to --

17 Q Right. Of course. Right. I'll just ask
18 you to make that assumption.

19 A Right.

20 Q So if that's true, then I guess we would
21 have to say that GAO was correct in saying that, for
22 the most part, first-class bulk mail delivery
23 performance is not measured.

24 A Certainly, that's not really incorrect.

25 I would mention one other thing with respect

1 to what Witness Mitchum said. It is the case that
2 local managers, plant managers, rather than try to
3 extract information from mailer-confirmed pieces,
4 maybe because the representation is fairly thin, but
5 when they find out from the XFC that they are missing
6 service commitments on a particular length from them
7 to a destination, they will put what are called
8 "seeds," in a different sense, in fair numbers into
9 their local input stream with confirm codes on, track
10 those, and there are plenty of reports of how that has
11 been helpful in identifying a sort of narrow service -
12 - issues that are hard to diagnose otherwise.

13 So, in that sense, it sort of confirms, in a
14 way, what Mr. Kiefer said, which is the regular
15 confirm stuff is not the -- choice, and probably
16 because it's kind of hard to use for that purpose. I
17 don't know more than that. There are other ways that
18 the confirm is helpful in correcting or diagnosing
19 where you should look to find out where the problem
20 is.

21 Q If postal management made a systematic
22 examination of confirm data on a regular basis, might
23 it not be able to spot bottlenecks or long delays that
24 it might want to take steps to correct?

25 A It certainly might. The fact that plant

1 managers are taking this alternative route might mean
2 that there are some shortcomings of the live confirm
3 numbers that I'm not aware of, but I think somebody
4 else looking at it who could discover something -- I
5 think it's a potential resource. More than that, I
6 can't say.

7 Q Getting back to GAO's representation of the
8 amount of mail that is not measured, GAO also states
9 that periodicals mail is 4 percent of mail volume.
10 Does that sound about right to you?

11 A Yeah. It probably rounds down to four, 10
12 billion out of 200 billion, so yeah.

13 Q And they then say that there is no
14 measurement of delivery performance for periodicals.
15 Is that your understanding also, that there isn't any
16 measurement?

17 A No Postal Service measurement.

18 Q Okay. So we've got 48 percent for standard
19 mail, 25 percent for first-class bulk mail, and 4
20 percent for periodicals. Let's see. Three plus four,
21 77.

22 A Close enough.

23 Q Close enough. We're getting close to Mr.
24 Baker's number, aren't we?

25 Let's accept Mr. Baker's number, and I guess

1 we would have to say, then, that only 20 percent of
2 mail may be measured, and you would agree, based on
3 these numbers, that he had gotten close in giving that
4 figure.

5 A Yes. I don't recall any particular number.
6 The back-of-the-brain calculation was a little too
7 quick. Anyway, yes.

8 Q One more point. That means that right now
9 the largest class of mail, standard mail, service
10 performance isn't measured, and for the next largest
11 class of mail, for first-class bulk mail, it looks
12 like more than half of that isn't measured.

13 A More than half of total first class.

14 Q Of total first-class mail, right, is not
15 measured. That must make it difficult, wouldn't you
16 agree, for the Commission to apply Section 3622(b)(2)
17 in setting the prices for mail, doesn't it?

18 A It certainly will make it difficult for
19 making fine-tuned adjustments. I think the initial
20 service levels were evaluated at a time when we didn't
21 have anything but ODIS for any class of mail, just the
22 history of things, and I don't see any reason to think
23 that the judgments were made at that time were way out
24 of whack.

25 So I don't think that what has happened is

1 greatly reduced in quality by the lack of these, but I
2 agree that it would be better to have more
3 information.

4 The other point that I would think is pretty
5 relevant is, for a first-class single piece, it's hard
6 for the individual consumer to have an idea of whether
7 his delayed mail is out of line with what should be
8 expected.

9 Any particular piece, you know, this was
10 postmarked a week ago, but how frequently should it
11 happen? And the same for priority mail, which is
12 partially single piece, but once you get into standard
13 and periodicals, mailers have put some effort into
14 tracking their own service, and when it looks like
15 it's going downhill, we hear about it directly and
16 investigate and usually can find what has happened and
17 make a corrective action. If we weren't able to do
18 that, you would hear about it; that is, the
19 Commission.

20 So I'm not sure that the handicap is quite
21 as bad as the number is just because the character of
22 the things that are measured are things that we're the
23 only people in a position to measure, and for the
24 other classes, customers can get an idea, not of the
25 whole class but of their own slice of it, with some

1 expenditure of time and effort, but that's what they
2 really want is their mail. They don't care about all
3 of the rest of the periodicals, all of the rest of
4 standard.

5 So with that qualification, we've targeted
6 the measurement where they are most needed, and as you
7 get further down the hierarchy, the standards get less
8 precise. You have a two- or three-day window for
9 standard mail, depending on the origin and
10 destination.

11 So I just wanted to put that additional
12 information into the record, not to say GAO has got it
13 100-percent backwards or anything. Those are issues
14 which it would be nice to have more data on.

15 Q You say you think that there is considerable
16 measurement taking place on the part of individual
17 mailers and periodicals and standard mail. Do you
18 have any idea what percentage of volume mailed is
19 being measured by mailers?

20 A Not really. It would only be a guess, and
21 what I would do to make the guess would be to look at
22 the volume by people who mail a lot. There are
23 anecdotes about how certain businesses depend on
24 tracking the performance of their local store by how
25 much of the sale items they actually move, and if the

1 sale flier doesn't get delivered, that's a frequent
2 excuse for -- local measurement.

3 So it doesn't have to be a huge mailing
4 operation, but it needs to be something that does use
5 the mail as an important part of the business, but
6 it's probably easier for a large company whose mail is
7 a huge fraction of its business to do it, but that's
8 pretty qualitative.

9 Q Right. So the Postal Service doesn't
10 measure performance for these major classes of mail or
11 substantial portions of major classes of mail, as we
12 went over a few minutes ago, but you think that
13 mailers may be measuring it, to some extent, but you
14 don't know to what extent. Right?

15 When the Postal Service fails to measure its
16 performance, I think it's logical to say that it has
17 no evidence it can present to the Commission for it to
18 consider.

19 A That's, I would suppose, would be the case.

20 Q Okay.

21 A I have one more little piece. With confirm,
22 the mail, the read, the scans went directly to the
23 customer or the computer experts that sort of serve as
24 people who can make sense out of the pile of scans,
25 and they would come to the plant and say, "Look.

1 Here's what happened to my mail," and the plant
2 manager didn't know. He had no basis for discussion
3 except what the customer had printed.

4 So we, fairly early in the game, developed
5 certain reports that we agreed would be shared. They
6 would be produced by us, probably pretty simple
7 things, and given both to the customer and the local
8 plant manager. But, again, that's not publicized.
9 It's particular to the customer. It's not filed with
10 the Commission.

11 Q In those instances where the Postal Service
12 prepares the reports for the customer, or in instances
13 where the customer does its own tracking, we're going
14 to arrive at the same point, that there is no evidence
15 presented to the Commission on the Postal Service's
16 delivery of these major classes of mail. Is that
17 correct?

18 A Certainly, nothing -- this is a very strong
19 phrase, "no evidence," but certainly no measures of
20 the sort that we do have for first-class single piece,
21 no question about that.

22 Q You mentioned the kind of information that
23 first-class retail customers might need from the
24 Postal Service, and you said, and I agree with you,
25 that they certainly want to know how long it will take

1 their first-class mail to be delivered to the
2 recipient. Do you know of any measures by the Postal
3 Service of the amount of loss of first-class retail
4 mail?

5 A From interrogatory responses, I believe that
6 the Postal Service understands that to be
7 extraordinarily small. We have the inspection
8 service. We have automated processes. There is some
9 mail which must get lost inside a machine occasionally
10 and maybe not found for a very long time, the old
11 stories of the rating counter in a post office has
12 some way it can slip behind, and a 40-year-old letter
13 is found when they move the furniture.

14 What I understand is that the belief of the
15 people who know more about the operations is that
16 there is really very little that just evaporates.
17 Either it gets delivered, or it's undeliverable as
18 addressed, or there is no forwarding address and no
19 return address in the case of first class, but there
20 are procedures for all of that, and I wouldn't count
21 those as lost.

22 We do our best, but there is not any basis
23 that we have for doing anything but sending -- either
24 wasting the mail for standard, for example, or in the
25 case of first class, sending it to what used to be the

1 dead letter offices, now called "mail recovery
2 centers," and they will put more effort into tracking
3 down a place to send it.

4 Q I agree with you that it wouldn't be fair to
5 count undeliverables, addressed mail, as lost mail,
6 but for properly addressed mail, does the Postal
7 Service have any formal measurement system of how much
8 of that is lost?

9 A I'm not aware of any. I'm not aware of any.
10 Let's just leave it at that, and I think I would be.

11 Q Is there any way for the Postal Service to
12 report the percentage of mail, and it might very well
13 be a low percentage of mail, that's lost?

14 A Well, I expect it to -- I was about to
15 expand on the measurement difficulties, especially if
16 you're trying to measure something that is expected to
17 be small. The first thing that comes to mind is for
18 single-piece mail. We already measure that. But for
19 some mail, I think this isn't going to work as well.
20 You could put a unique ID code on the piece the first
21 time you see it and then see if that shows up at the
22 end at a delivery unit or thereabouts. You probably
23 would take the last pass of DPS as a possibility of a
24 pretty good measure.

25 The bulk, work-shared, first-class mail is

1 in trays that don't get opened until they get to the
2 destination plant. Right now, there is some that's
3 even carry route and doesn't get opened until it's in
4 the station where it is handled manually. There are
5 lots of things that would have to be considered but
6 might be something to deal with.

7 I think we would want to discuss this with
8 customers before we put money into it, their money,
9 basically, but there might be some ways to do it. I
10 just don't know.

11 Lost mail; I think that's going to be real
12 hard to determine reliably because you're not going to
13 know, if there is no scan on the destination end,
14 whether it got lost or whether the scanner wasn't
15 working properly, misread. That strikes me as real
16 hard, so I'm not optimistic on that.

17 Q Even mail that's entered in trays and
18 doesn't receive a piece sortation until a later stage
19 downstream, that might be lost also, mightn't it?

20 A Sure. That would be an even more difficult
21 case unless we can track the pieces back to the entry
22 point by, say, a bar code on the container because you
23 don't have an entry record. All you have, if it is
24 delivered, is the delivery end of the scan, but we
25 don't know precisely enough, I think, about -- we know

1 the total pieces entered by bulk mailers because of
2 the mailing statements in their revenue, but on the
3 assumption that there is not very much lost, I think
4 even there, if we could scan every piece at delivery
5 and say, well, we collected postage on this many
6 pieces, and we've delivered this other number of
7 pieces, and this week or this year, the delivery is
8 smaller. Given the timing, it might not actually work
9 out that way all of the time.

10 Before you're really sure about that, you've
11 got to account for all of the pieces sent to the mail
12 recovery center or pieces, not first class, so they
13 accept them in particular agreements with mailers that
14 if they can't be delivered, they are trashed. What
15 else can happen with first -- that's probably about
16 it. I guess "return to sender"; that would be a
17 special effort, but at least we know we had it, and if
18 it's delivered back to the sender, we know it was
19 delivered rather than lost. Some of those things are
20 just handled by a carrier, and they cross out the
21 address.

22 Q Do you know what percentage of first-class
23 mail is misdelivered, or do you have some idea about
24 that?

25 A There are numbers about that. I don't

1 recall what they are. I haven't seen anything
2 recently, but it's at least, depending on how you
3 define "misdelivery," it's not a fraction of a
4 percent; it's more than that. It might be several
5 percentage points.

6 Q Right. That's what I've heard. Now, that
7 does tend to detract from the value of first-class
8 mail, doesn't it, when these pieces are misdelivered
9 and possibly don't get into the hands of the
10 recipients. Would I be right in thinking so?

11 A Well, certainly, if nothing else, it delays
12 the mail because, assuming everybody is on good terms
13 in the neighborhood, if that's what we're talking
14 about, you get home and find a piece for the neighbor,
15 and you take it over and put it in the slot until the
16 next morning.

17 Certainly, if a recipient gets something
18 that looks like it's third class -- sorry, standard --
19 I was trying to avoid a third term -- there are
20 certainly possibilities that things can go awry.
21 Occasionally, a truck carrying mail crashes and burns.
22 We know generally what destination the mail was and
23 how many pieces, but that's something like lost mail.
24 It doesn't evaporate, but it's not delivered. So
25 there are lots of things which happen, but as a

1 percentage, misdelivery, I think, is a much bigger
2 problem in terms of customer satisfaction than it
3 probably is in causing pieces to never get delivered.

4 Q OCA has been looking into the reduction by
5 the Postal Service of the number of collection boxes
6 over a period of time. Are you familiar with that
7 trend, that the Postal Service has been reducing the
8 number of collection boxes available for entry of mail
9 over a period of years?

10 A I'm not really familiar with it from the
11 postal side. Maybe it's interrogatories or something
12 like that, but I don't have any information that is
13 not already available from some other source.

14 Q Well, I'll ask you to accept two premises,
15 and these will be subject to check, first that the
16 type of mail primarily entered at a collection box is
17 first-class mail. Does that sound reasonable?

18 A Yes. Uh-huh.

19 Q And, second of all, that the Postal Service
20 has been reducing the number of collection boxes over
21 a period of years. Would you agree that that makes
22 first-class mail less valuable because it may impose
23 greater burdens on single-piece, first-class mailers
24 to enter the mailing system?

25 A I guess I could say that that's a

1 possibility, but I think local management is going to
2 weigh some considerations. They have, I think, a
3 pretty good idea how much mail is actually being
4 deposited and collected from various boxes. If that's
5 small, and I wouldn't be surprised if the proportion
6 has changed gradually because more people are in the
7 labor force, and it's a rare workplace that doesn't
8 have a very convenient place to mail.

9 So it may be that the deposit of mail in
10 total in collection boxes has gone down and that you
11 can identify certain boxes in neighborhoods where it's
12 gone way down, and we're spending some dollars, some
13 of the customers' dollars, to stop the truck and open
14 a box and take out a handful of letters, and maybe,
15 overall, the consumer would prefer that we not spend
16 those dollars. It's -- option, for sure, but it's not
17 such a big loss of value of service, if you want to,
18 but it could be. I wouldn't want to go directly from
19 the two assumptions to the necessary conclusion that
20 it reduces service.

21 If you go around and pick up boxes randomly,
22 sure, but we don't do that; we select. So I would not
23 expect a big, if any, impact on the value of service
24 from that policy.

25 Q Well, I'll give you an example that I

1 experienced today, and I was conscious of the fact
2 that I was going to cross-examine you today, so I made
3 a point of looking for it. There is a certain route
4 that I drive to work every day. It takes me through a
5 neighborhood. I've noticed this collection box over
6 the years. There has been a collection box on this
7 one corner. I knew about the trend to remove
8 collection boxes, so I thought I would look for it
9 today. Well, when I drove past that corner, it wasn't
10 there anymore.

11 To the best of my knowledge, there isn't any
12 other collection box in that neighborhood, and the
13 folks in that neighborhood who might have been able to
14 walk to it before will now, if they have no other
15 reason to go out, but they need to mail a letter, they
16 might have to get into their car and drive maybe two
17 or three miles to get to the nearest post office to
18 mail a letter.

19 A The alternative would be to leave it for the
20 carrier.

21 Q Right.

22 A So there is always that alternative. If
23 your hypothesis is right, that they do have to go in
24 their car, that's unfortunate and might be construed
25 as a reduction in service, but you still need to know

1 what you're spending to service that box before you
2 really know what would be a good approach to the
3 problem. The individual who is in that situation
4 isn't going to be concerned too much about the
5 overall, but we need to be.

6 I was going to ask you -- you've seen the
7 box. Have you ever seen anybody put anything into the
8 box?

9 Q Not that I can recall, but I'm only there
10 for a couple of seconds. At the rate I drive,
11 actually, it's a really fast trip past the box, so --

12 A Just from the point of view of the other
13 opportunities that are increasing, or at least
14 increasingly available because of more people in the
15 labor force, it may be that there is a no reduction in
16 the convenience of putting mail into the stream.

17 Q Right. Well, I'll just add one more fact,
18 and let's see if I can get you to agree, that there is
19 a reduction in the value of service. This happens to
20 be a neighborhood where there seem to be older homes
21 and, I think, mostly an older population, so I would
22 have to, at least for this neighborhood where the
23 collection box disappeared, these would be older
24 people, most of whom, I'm guessing, are not going to
25 work every day.

1 A Right.

2 Q So for them, it sounds like it's a reduction
3 in the value of service for first-class mail for them.

4 A I come back to the possibility of leaving it
5 for the carrier, and if they are not working, they are
6 likely to be familiar with the carrier's routes. They
7 hear the slot open. So I think they still have a
8 pretty convenient method, and it's maybe the exercise
9 that, as a society, we ought to be concerned about,
10 not the value of service. But that could be the case
11 that somebody somewhere suffers, but I think other
12 people in other places gain. I just can't go there.

13 Q Let me switch, then, to myself. I've got a
14 curbside mailbox, and you're suggesting that if a
15 collection box that I used to use disappears, I can
16 just put my check for electric service in my curbside
17 box, put up the red flag, and have the carrier pick it
18 up. My letter isn't going to be nearly as safe in my
19 unlocked, curbside box as it would be in a collection
20 box, would it?

21 A It's certainly easier to get. Right.

22 Q Okay.

23 A We do care about what happens with mail in
24 those boxes, but, you know, to focus on one thing,
25 yes. Since you do come to work, hand it directly to

1 the postal inspector.

2 Q I'll hand it to you, Dr. O'Hara, the next
3 time I see you.

4 A Find a place to deposit it.

5 Q Let me ask you about some other services
6 that consumers use, to a considerable extent.
7 Consumers use a number of special services like
8 certified mail on occasion, delivery confirmation.
9 Does the Postal Service measure how well it's
10 providing certified mail, as an example?

11 Two of the dimensions I can think of that
12 would seem important for certified mail would be the
13 length of time that it might take for certified mail
14 to be delivered; if return receipt has been added, the
15 length of time to receive that return receipt; and
16 also the number of instances in which the service
17 isn't provided at all. Do those sound like pretty
18 important elements of that service?

19 A Well, certainly, we ought to provide the
20 service that's requested. The time that's actually
21 involved between the time a return receipt is signed
22 may be affected by there being nobody home to sign for
23 it. If it was priority mail, it would have a delivery
24 attempt recorded, which you could say whether or not
25 it's within the normal delivery standard for the

1 piece, without regard to the service. Beyond that, I
2 probably don't know enough.

3 We do scan -- I think we scan certified
4 mail. The new labels have a bar code on them. I know
5 we scan some of the insured parcels, pieces. So I
6 just don't know quite enough detail about what is done
7 now, but those are things which are, as they say,
8 special services.

9 People pay a premium, and we ought to, cost
10 permitting and all of that, have a way of measuring
11 how well we do, whether it's time to delivery or time
12 for the return or the percentage of pieces where the
13 return, if it's been requested, actually gets back.
14 That might be more critical for that particular case,
15 but if you're not requesting a return receipt -- I
16 think it would be good. I don't know anything about
17 the practicalities of doing that.

18 Q But you would agree that if expense isn't
19 terribly significant, that it is good to measure the
20 performance of those services to make sure that they
21 are being provided.

22 A That's always a consideration, and if it can
23 be done, because in the case of the special services,
24 it ought to be attached to the cost of the special
25 service, not the outgoing piece, then we ought to look

1 at that. I think that would be an increase in the
2 value of the service for those products.

3 Q I'm going to take up one more matter with
4 you. This is my last question or two. I've gone a
5 little over what I said but not too much, I think.

6 Are you familiar with at all with the
7 publication in the airline industry of detailed
8 information about flight delays, mishandled baggage?

9 A Yes. Correct.

10 Q I pulled off the Internet the most recent
11 report issued by the Department of Transportation, and
12 it's called the "Air Travel Consumer Report," and I
13 see here that for many, many of the airlines that are
14 commonly used domestically, that this report, for
15 every airline, will contain the number of times
16 flights were delayed, the length of time they were
17 delayed, the number of bags mishandled per thousand --

18 A You mean meaning misdirected as opposed to
19 banged up?

20 Q I'm not sure. I don't know how they define
21 it. I see the label "mishandled baggage," so I don't
22 know. I assume there is something unsatisfactory.

23 A Yes. It's probably easier to track whether
24 it gone on the same plane as the passenger, a later
25 plane to the same city, a plane to a different city.

1 "Misdirected" was the word I thought might apply, but
2 I agree, there is something that causes a complaint.

3 Q Okay. Apparently, another thing regularly
4 measured and reported is oversales, which I imagine
5 would be too many seats sold for a given flight, so
6 somebody gets bumped.

7 A Yes.

8 Q Also, the number of consumer complaints for
9 each airline is measured and reported. Do you think
10 that postal customers would be better served if they
11 had access to measures of this type that our
12 appropriate for postal services?

13 A It's possible. We have, for single piece,
14 first class and, to some degree, for single-piece
15 parcels, we have the averages, which are what you have
16 there, of delivering in terms of number of days, which
17 is about the way we offer the service. We don't offer
18 a 15-minute window, which the airline schedules often
19 are.

20 So I think it would come down to whether
21 there is a way to collect data that's meaningful to
22 the consumer, not just the closest analog we can find
23 to what the airlines do, at a reasonable cost. I
24 don't really know enough to say whether that's likely
25 or may be something that would be the case or entirely

1 unlikely. That's all I can add.

2 MS. DREIFUSS: Okay. Thank you very much,
3 Dr. O'Hara, and thank you, Mr. Chairman.

4 CHAIRMAN OMAS: Thank you, Ms. Dreifuss.
5 Mr. McKeever.

6 MR. McKEEVER: Thank you, Mr. Chairman.
7 John McKeever for United Parcel Service.

8 CROSS-EXAMINATION BY UPS

9 BY MR. McKEEVER:

10 Q Dr. O'Hara, a long time ago counsel for
11 Amazon.com asked you a series of questions comparing
12 the cost coverage for bound printed matter to the cost
13 coverage for parcel post in light of the educational,
14 cultural, scientific and informational value factor in
15 the statute. Do you recall that?

16 A Yes.

17 Q Looking at that factor alone, the
18 educational, cultural, scientific, information value
19 factor alone, you would expect parcel post cost
20 coverage to be higher than that for bound printed
21 matter given that bound printed matter gets some
22 consideration of --

23 A Almost equal.

24 Q Thank you.

25 Dr. O'Hara, do you agree that comparing

1 marked up indexes is a better way to compare changes
2 in contribution to institutional costs from one case
3 to the next than using cost coverages?

4 A I generally prefer cost coverages, actually.

5 Q You do prefer cost coverages.

6 A Yes.

7 Q Even when comparing from one case to the
8 next?

9 A Yes. My reservation about markup indexes is
10 that the major chance to exaggerate in some sense, I'm
11 not able to explain right now, the degree of change.
12 But in a lot of cases they'll at least give you the
13 same qualitative, that is directional and relative
14 magnitude of the kind of information. So it may be
15 that my preference is irrelevant to your question.

16 Q Do you know whether the Commission prefers
17 to use markup indexes in comparing cost coverages from
18 one case to the next and over time as opposed to
19 cost --

20 A Well --

21 Q They prefer markup indexes?

22 A -- their practice and I presume it's their
23 preference.

24 Q Okay. Do you happen to have with you today
25 a copy of Library Reference 114 which compares markups

1 and markup indexes, indices, in this docket to those
2 in the prior dockets?

3 A No, I do not.

4 Q I take it I think from your colloquy for
5 Amazon.com that you also don't have a copy of the
6 Commission's Appendix G, Schedule 3 in its last
7 decision which compares markup indexes over time for
8 the different classes of mail?

9 A That's correct.

10 MR. McKEEVER: Mr. Chairman, with your
11 permission I would like to supply the witness with a
12 copy of each of those documents.

13 CHAIRMAN OMAS: Please do.

14 (Pause).

15 BY MR. McKEEVER:

16 Q Dr. O'Hara, if you could first take a look
17 at the Appendix G, Schedule 3 from the Commission's
18 decision in Docket R2005-1, the last case, that I've
19 given you. Do you have that?

20 A Yes, I do.

21 Q That docket indicates that in R2005-1
22 modified, the markup index for parcel post was 0.264,
23 is that correct?

24 A Yes.

25 Q And if you look at Library Reference L-114,

1 the markup index for parcel post under the Postal
2 Service's proposal in this case is 0.173 using the
3 Postal Service's costing, is that correct?

4 A 0.173?

5 Q Yes.

6 A Yes, I see that number.

7 Q That 0.173 is the lowest of all the major
8 classes of mail except media mail and periodicals, is
9 that not right?

10 A Yes.

11 Q And it is far lower than the markup index
12 for standard mail which is 0.898, is that correct?

13 A That's on PRC costs?

14 Q Using Postal Service costs, 0.866, it's far
15 lower than the standard mail markup of 0.866, correct?

16 A Correct.

17 Q And standard mail I think you said in your
18 testimony on page 27 has a relatively low intrinsic
19 value of service, is that correct?

20 A That's correct.

21 Q To the extent that the size of a rate
22 increase is a factor that you take into account in
23 determining appropriate cost coverages, am I correct
24 that there are services in this case that have a rate
25 increase higher than that proposed for parcel post?

1 A If I could just check, since that isn't my
2 exhibit -- a rate increase higher?

3 Q Higher than that proposed for parcel post.

4 A Yes.

5 Q In fact do you know whether in prior cases
6 there have been rate increases as high as 25 percent
7 for certain classes of mail?

8 A I can't cite a particular example but I
9 presume that's happened.

10 Q In response to some questions for counsel
11 for AAPS you stated that the Postal Service does not
12 focus on specific weights for parts of a class of mail
13 in an effort to get volume from a competitor. Do you
14 recall that?

15 A Yes.

16 Q Are you surprised that Mr. Kiefer in
17 designing his rates for parcel post in this case
18 constrained the rate increases for parcel select to a
19 level lower than the constraint he imposed for retail
20 parcel post?

21 A Not really.

22 Q You knew that?

23 A I'm not sure I could have answered that
24 question, but I do know that the coverage on parcel
25 select, I believe I know. I don't think I have

1 anything on it in my testimony. I believe that the
2 implicit coverage or markup on parcel select is higher
3 than that on retail. So if you're trying to move
4 things a little closer together, which might or might
5 not be the right thing to do, you would have to do
6 that if you're going to have any constraints at all.

7 Q Haven't you testified though that you would
8 expect and in fact would want the cost coverage for
9 work shared mail to be higher than that for non work
10 shared mail?

11 A I would, yes. So the mere fact of
12 inequality in that direction doesn't necessarily mean
13 you should try to move them closer together by raising
14 prices for single piece. That's exactly correct.

15 Q Do you know whether any parcel post rates
16 would actually be decreased under the Postal Service's
17 proposal in this case?

18 A I don't know off-hand.

19 MR. McKEEVER: That's all I have, Mr.
20 Chairman.

21 CHAIRMAN OMAS: Thank you, Mr. McKeever.

22 Mr. Olson?

23 CROSS-EXAMINATION BY VALPAK

24 MR. BY OLSON:

25 Q Dr. O'Hara, Bill Olson for ValPak this time.

1 A Right.

2 Q I want to begin with some questions about
3 our interrogatories that were followups 7, 8, and 9
4 that Mr. Baker has asked you some questions about.

5 Those interrogatories were filed on August
6 10, does that sound about right?

7 A It does sound right actually, and it says so
8 on the cover page.

9 Q Today is not actually the day you were
10 originally scheduled to testify, correct?

11 A That's correct.

12 Q It was the 3rd and it got moved to the 30th?

13 A Correct.

14 Q At the time the Postal Service asked the
15 Commission to move they suggested that a partial
16 remedy for lateness in interrogatory responses would
17 be that all followup questions would be answered
18 within 7 days which would have been August 14th, and
19 that schedule didn't get met, right?

20 A That did not get met. I think seven days
21 would be the 17th.

22 Q I'm sorry, they were filed on the 7th. I
23 gave you the wrong date. They were filed on the 7th.

24 A But I typed that in so I may be wrong.

25 Q I think this is right. So the 14th would be

1 seven days and that deadline didn't get met, right?
2 And then the Postal Service said but certainly at
3 least two days prior to Witness O'Hara's proposed
4 appearance in the hearing room on the August 30th it
5 says, and that deadline didn't get met, correct?

6 A Let's see here. Right.

7 Q To days ago --

8 A The 29th.

9 Q Do you know what time on the 29th they were
10 filed?

11 A I can probably look at it here. 3:55.

12 Q Right. Yesterday.

13 A Yesterday.

14 Q Knowing you and your counsel for a very long
15 time I know you both have stellar reputations. My
16 point is not to criticize but to say that you do
17 realize that it takes sometimes lawyers time to
18 develop questions for witnesses?

19 A Absolutely.

20 Q Not that this would be your purpose.

21 MR. OLSON: But it does put us in a bind,
22 Mr. Chairman, which I would like to address at this
23 time, which is that I have in candor been totally
24 unable to prepare any questions for the answers which
25 we thought we were going to get on August 14th and did

1 not come by August 28th, and did come yesterday, at
2 3:55 I think it was yesterday.

3 I don't know if I'm going to have any
4 questions about those. I haven't really read them and
5 understood them. I admire Mr. Baker for having had
6 questions about it, but I don't. I would like to
7 clarify, if we could, even though testimony is due in
8 a week, and I probably don't have time to worry about
9 it until the testimony is done, but if we do have
10 questions if we could pose them, given the lateness of
11 the time that the responses came in, and if the Postal
12 Service would respond --

13 CHAIRMAN OMAS: Mr. Tidwell?

14 MR. TIDWELL: The Postal Service would have
15 no objection and would make every effort to respond
16 expeditiously.

17 CHAIRMAN OMAS: Thank you.

18 MR. OLSON: Thank you, Mr. Tidwell. Thank
19 you, Mr. Chairman.

20 BY MR. OLSON:

21 Q You also amended your testimony last Friday,
22 correct?

23 A The 25th, yes. Most of that was to get the
24 right numbers from the exhibits worked into the
25 testimony where appropriate. I changed a couple of

1 sentences where circumstances -- One was a simple
2 admission of noting the incremental costs relative in
3 any county, and then something about the Forever Stamp
4 had changed, but most of it was just to get the
5 numbers in the testimony to agree with the numbers in
6 the revised exhibits.

7 Q At the time the amended testimony was filed
8 there was a helpful notice that explained the errata
9 also dated August 25th, correct?

10 A Yes.

11 Q I have a couple of questions that go to the
12 changes in your testimony. Maybe this is obvious. I
13 didn't notice it in the response, but if you don't
14 mind at least we can put it on the record.

15 A Not at all.

16 Q On page 27 of the new testimony you changed
17 I believe here the coverage proposed for standard
18 regular from 167 to 176, is that correct?

19 A 176 is there and if I look at the notice --
20 That does ring a bell. The main, I'm sure that's
21 right.

22 Q If you could check, I'm not sure that's
23 right.

24 A The numbers are freshened up in my memory at
25 least.

1 MR. OLSON: Mr. O'Hara, would you --

2 WITNESS O'HARA: Right.

3 CHAIRMAN OMAS: It's great that you're
4 relaxed, but we still need to hear you.

5 WITNESS O'HARA: I do like to turn a little
6 bit. I'll try to stick close to the microphone.

7 Where were we?

8 BY MR. OLSON:

9 Q It didn't appear to me to be in the notice
10 that you described --

11 A It's not mentioned specifically. What
12 happened with the coverage, let me look through the --

13 I think that one of the adjustments, and I'm
14 having trouble being sure about that. There are two
15 adjustments across that hit a lot of sub-classes on
16 the costing side because initially a couple of
17 programs that will generate savings in the test year
18 had been distributed using an inappropriate
19 distribution fee.

20 One of those was -- Nope. The coverage went
21 up, the cost went down. The rates didn't change.

22 The particular program that did it was the
23 APCs. For those of you who are long-time postal
24 participants, you might recognize APC as an all
25 purpose container. But we have a new APC which is an

1 automated postal center, where people mail packages
2 with credit cards and so on without taking time at the
3 window. We expect a recommendation, window savings
4 time as a result of that.

5 Initially, however, the savings from that
6 program were distributed to mail processing. I think
7 somebody must have assumed that an APC in this case
8 referred to an all purpose container which are used in
9 mail processing.

10 When it was discovered that there was
11 another kind of APC, and this was something to
12 generate savings in window services those were pulled
13 back out of mail processing and applied to window
14 service.

15 Nope. I'm sorry. For some reason my logic
16 was going to work very well with priority mail but
17 you're asking about standard regular.

18 (Laughter).

19 Q I could ask that question, if that would be
20 helpful.

21 (Laughter).

22 A Standard mail's cost went down, priority
23 mail's costs when down when that correction was made,
24 but I don't think it applies to regular.

25 The other correction, I can't get anything

1 out of costs. The other cost correction had to do with
2 the air transportation savings, and that's not going
3 to hit standard regular either.

4 Q I'm sure these things blur together. It may
5 be the best way for us today is to ask if you might be
6 able to address that.

7 I do think this is a significant change in
8 the testimony, change from 167 to 176 is a big change
9 and deserves an explanation which may not be easy to
10 give today.

11 A That's right. There were a couple of changes
12 that were due to typos on my part in the testimony,
13 where even in the original exhibits the right numbers
14 were there. I'm not sure whether this is one of them
15 or not, but we will run this down.

16 Q Before you do that can you also tell me if
17 you look at the bottom of page 30, the last number you
18 have there, you talk about the cost coverage of
19 standard regular is 177. Is it 177 or 176?

20 A what does it say in the exhibits?

21 Q One of these is in error, I guess.

22 A That's correct.

23 Q Perhaps you could clarify that as well.

24 MR. OLSON: Mr. Chairman, while the witness
25 is writing, can we obtain a date from counsel perhaps

1 to provide this information for the record?

2 As we get toward filing of testimony I know
3 things are, for us it's going to become difficult, but
4 whatever early date would be most helpful.

5 MR. TIDWELL: I believe we're in a position
6 to commit to filing Friday. No later than Friday.

7 WITNESS O'HARA: No later than Friday.
8 These two certainly might be easily resolved when I
9 get back to the office. Maybe not, though. I
10 shouldn't count on that because there have been other
11 changes before the errata that took a long time to
12 unravel.

13 I've got those two written down and we'll do
14 it as quickly as the problem lets itself be solved,
15 but as counsel says, no later than Friday.

16 CHAIRMAN OMAS: Is that okay, Mr. Olson?

17 MR. OLSON: Yes, it is. If that's the
18 Chairman's order then I'll feel better.

19 (Laughter)

20 CHAIRMAN OMAS: Would you please provide
21 that, Mr. Tidwell, to the Commission, by Friday, close
22 of business?

23 MR. TIDWELL: Yes, Mr. Chairman.

24 CHAIRMAN OMAS: Thank you, Mr. Tidwell, and
25 Mr. O'Hara.

1 Mr. Olson, you may proceed.

2 BY MR. OLSON:

3 Q The other change in standard coverage that I
4 see is on page 29 where I believe the ECR coverage
5 level was 213 and went to 214, is that correct?

6 A Yes. At least I have a reason for that.

7 Q The DAL issue?

8 A The DALs. We had assumed that we would only
9 get I believe it was, have 50 percent of the DALs that
10 we think we have today and we'd only get that much
11 revenue but no cost reductions were there so we went
12 back and assumed we'd get revenue on the whole thing.

13 Q The one percent change is explained in your
14 notice. the nine percent change is not addressed.
15 That's why I wanted to clarify that.

16 A Absolutely.

17 Q I guess I might as well --

18 MR. OLSON: Sorry to keep dragging you into
19 this, Mr. Chairman, but if we wind up with questions
20 based on the response that we get and we need to ask
21 them, will counsel's earlier agreement apply, that
22 they will help us with some additional questions if
23 they're needed?

24 CHAIRMAN OMAS: Mr. Tidwell?

25 MR. TIDWELL: Yes.

1 CHAIRMAN OMAS: Thank you. Would you please
2 provide that to us in writing?

3 (Laughter).

4 CHAIRMAN OMAS: Thank you.

5 BY MR. OLSON:

6 Q Let's switch to an interrogatory we asked,
7 ValPak-1.

8 A Yes.

9 Q The same motion to reschedule indicated that
10 the Postal Service expected to file the responses no
11 later than August 2nd, at least I was sure on July
12 27th, and that didn't happen. Correct?

13 A Right.

14 Q So they were filed Monday, August 28th?

15 A Yes.

16 Q 4:10?

17 A 4:10.

18 Q That's a day and a half ago, so at least I
19 have a couple of questions on that.

20 A Okay. I have to apologize to people
21 generally for the delays in interrogatories. None as
22 extreme as ValPak-1, but a lot of them. Some of them
23 were going to take time and possibly depend on the
24 answers that resulted from the changes to the
25 workpapers and that took a lot more time than I

1 expected.

2 So I certainly would make every effort, as
3 Mr. Tidwell has said, to get these responses back as
4 fast as we can.

5 Q Thank you.

6 Let's talk about that, your response to
7 1(b). At least we wrote a challenging question, I
8 guess.

9 A Yes. That's another reason that they didn't
10 get answered immediately. Those are important and not
11 simple to respond to.

12 Q Let's look at (b) again. You in your
13 response talk about, in the second paragraph, ECP is
14 directed to providing the right price incentives to
15 induce customers to do a particular operation, and you
16 talk about some piece of mail which is sorted to three
17 digits changing to five digits.

18 A Yes.

19 Q This is consistent with much of the earlier
20 cross today where you say that as mail gets more work
21 shared you expect a higher markup.

22 A Yes.

23 Q Let's take the example that you use. This
24 was not in our question, you came up with this
25 illustration of a three digit piece converting to a

1 five digit piece, correct?

2 A I thought that was a good example of
3 component pricing and I need a concrete something. So
4 anyway, yes, it's my choice.

5 Q In your example you're talking about
6 changing level of pre-sort which is clearly work
7 sharing, correct?

8 A Yes.

9 Q What you seem to be indicating is that you
10 would, in the next page at the end of your answer to
11 (b), you say customers doing the five digit sort are
12 rewarded by the full amount of the Postal Service
13 savings but no more. Their contribution to
14 institutional costs does not change. Correct?

15 A Up or down, yes.

16 Q So if the amount of absolute contribution to
17 institutional costs does not change, then the markup
18 or coverage increases.

19 A Yes, and the point of the answer at least is
20 that is a direct result of efficient component
21 pricing, not something that was dragged out of the air
22 by me or somebody else. It's just arithmetic. If you
23 reduce the rates by the amount of cost savings, the
24 cost contribution doesn't change, but the coverage
25 goes up. Just arithmetic.

1 Q Can I infer from this that that's the way
2 you believe it ought to be?

3 A I think that's an important thing to
4 examine. I don't think that a 100 percent pass-
5 through or is through some other mechanism unchanged
6 contribution per piece is necessarily the way it ought
7 to be. But I'm an economist and I understand the
8 reasoning. I think in the postal context we speak of
9 lowest combined cost as a desirable way to arrange the
10 division of labor between the Postal Service and its
11 customers. This does that, ECP, efficient component
12 pricing does that.

13 If the customer can do it cheaper then the
14 discount which matches our savings, it should, the
15 total costs, the combined costs will be lower. So
16 that's a piece of it.

17 We also have to worry about, that's why it
18 looks at the narrow decision between different level
19 to pre-sort. We are in the, in a situation of having
20 to raise the amount of money to cover the
21 institutional costs so you can't stop there. There
22 has to be something above the cost of the piece un-
23 pre-sorted or manually pre-sorted as a starting point
24 and then the point leads me to compensate, if you
25 will, if not reward, people for reducing our costs by

1 doing work sharing.

2 But if you're also going to reduce the cost
3 coverage, which might be warranted, you're going to
4 have to raise somebody else's dollar contribution to
5 the institutional cost and that's where the balancing
6 comes in and that's why it really would be a mistake
7 to say, just for a minute, to internal consistency.
8 Yeah, I would like to keep everybody's cost coverage
9 the same as work sharing increases or as other things
10 happen to reduce volume variable cost. That might be
11 deployment of new bar code --

12 That's the sense, it's a good idea to look
13 closely at that, but it's not the end. That's the
14 easy part of the decision, although we certainly also
15 look at rate shock kinds of issues there and sometimes
16 look to the future if we think that the savings will
17 be expanded or reduced. Nothing of that sort in this
18 case has specific mention I think.

19 Anyway, it's a good thing but it's not
20 necessarily, the way things necessarily ought to be
21 because there are other considerations that just don't
22 get taken into account in that calculation.

23 Q If we think of that as a good first step
24 then you're talking about the unit coverage or five
25 digit piece that converts to three digits staying the

1 same. The unit coverage staying the same. That's the
2 good first step.

3 A Uh huh.

4 Q Does that evidence a belief on your part
5 that all pieces within a sub-class should pay the same
6 unit contribution?

7 A Not necessarily. Certainly there are in a
8 sub-class such as first class where there are
9 different rates for different weights of pieces, I
10 think you look at a letter with four sheets of paper
11 in it, a one ounce letter; ten sheets would be at
12 least two, maybe three; that there's some that could
13 say the rates should be higher and it might make sense
14 in terms of raising the required contribution to make
15 it, the amount by which it's higher, larger than the
16 amount that the cost increases, for example.

17 It's not exactly a pass-through but it would
18 definitely result in a higher contribution per piece
19 for the heavier piece.

20 Q Let's put this in the context of standard
21 ECR, if you don't mind.

22 A Sure.

23 Q Within the ECR sub-class we have saturation
24 letters, for example, that particularly when they're
25 entered as DSCF or DDU have a reasonably small unit

1 cost we hope, correct?

2 A Right.

3 Q We also have within ECR pieces like basic
4 parcels that are entered at originating plants,
5 originating facilities.

6 Let's take a simple illustration where the
7 destination entered letter, saturation letter, has a
8 cost of 10 cents and the origin entered parcel has a
9 cost of 90 cents. If the average unit contribution
10 for the sub-class is 10 cents, I take it you're not
11 saying that you markup the letters from 10 cent cost
12 with 10 cents and charge 20 cents and you take the
13 parcels with a 90 cent cost, add 10 cents and charge a
14 dollar. That's not what you're advocating?

15 A Yeah.

16 Q And you don't think ECP requires that, I
17 take it?

18 A No. Partly because ECP is really aimed at
19 getting the right person to do a particular activity,
20 right entity. I don't think we are getting anybody to
21 change parcels into letters by keeping the
22 contributions the same, having the difference in rates
23 the same. That's something that involves what the ECP
24 is really aimed at. So I agree, you don't want to
25 apply equal percent per piece contributions across the

1 whole range of pieces within the sub-class.

2 Q So that would relate to shape-related costs
3 in your comments, and also really weight-related
4 costs. Correct?

5 A Yes.

6 Q What about transportation costs? If the
7 Postal Service incurs transportation costs should
8 those costs be passed on to the mailer 100 percent and
9 no more?

10 A Well, that would be the implication of the
11 ECP and there there is a choice as to whether the
12 mailer does the transportation or gives the mail to us
13 upstream and we do the transportation. So the same
14 general rule. That would be a good first step to look
15 at and see what you're achieving or not achieving, or
16 how far from the results you are. Yeah.

17 Q But for example in let's just say priority
18 mail as an illustration, is the Postal Service
19 proposing passing through transportation costs at
20 cost?

21 A I don't believe we do.

22 Q You mark them up in fact.

23 A Yes.

24 Q Mark up weights, mark up transportation?

25 A Yeah. But that is again a case where

1 there's not a choice really being made of should the
2 customer get on the plane with the piece or -- So
3 you're not as directly influencing behavior by doing
4 that. But I think there are other, whether or not
5 that move the value of service concept but also the
6 lack of effect on reducing combined costs. There's
7 even something to be said for having rates that
8 increase with distance and weight as a simple,
9 understandable thing in the retail environment, single
10 piece environment. So there are all these other
11 considerations.

12 In parcel post I know our precedent is to
13 not aim for equal contribution per piece.

14 Q Let's get away from the concept of costs
15 incurred by the Postal Service and just talk about
16 costs avoided for a moment. And getting back to your
17 comments about maintaining equal unit contribution of
18 that five digit piece and three digit pre-sorted
19 piece.

20 Let's have a different hypothetical to
21 clarify this. Let's assume we have an ECR saturation
22 letter that has a unit volume variable cost, marginal
23 cost, of 10 cents and an ECR basic letter that has a
24 unit volume variable cost of 20 cents. We're assuming
25 that unit volume variable costs are proxy for marginal

1 costs I take it?

2 A Yeah.

3 Q The difference between the basic and
4 saturation letters there is 10 cents.

5 A Yes.

6 Q That is I take it what you would call the
7 avoided cost of having a saturation letter, correct?

8 A As opposed to a basic letter, yes.

9 Q Now if in the hypothetical you have the ECR
10 basic letters paying a unit contribution of 12 cents,
11 so add that to the 20 cent cost, and you're paying a
12 rate of 32 cents I think that is, then when you do the
13 math you're charging a markup of 60 percent on the
14 basic letters, correct?

15 A Yes.

16 Q Now let's go back to the saturation letters
17 and let's assume we're having the same unit
18 contribution. So it's a markup over the 10 cent cost
19 plus 12 cents, and you're charging a range of 22 cents.

20 A Yes.

21 Q Here's the question. Should we view the 12
22 cent markup on the ECR saturation letter as a markup
23 on the cost that the Postal Service incurs to handle
24 that letter? Or are we to base rates on the cost that
25 the Postal Service avoids?

1 A I think those two come to the same thing.
2 The rates are really for what we do and what we avoid
3 is what we don't have to do because the mailer does
4 something. I don't see the distinction.

5 Q One distinction is you can measure costs
6 incurred, but costs avoided don't show up in any
7 accounting system.

8 A That's correct. We use mail processing
9 models and special cost studies to get a handle on
10 those in order to have a cost basis for the rates.

11 Q And to do that then you have to make
12 judgments about which costs you're going to measure.

13 A Yes, the cost witnesses do that and I have
14 to say it seems pretty arcane to me, but they do it
15 and their process results are open to examination by
16 individuals. So I just basically don't want to try
17 and confuse the record on that.

18 Q No, no. But it really does, when you try to
19 change things and think about cost avoidances, you do
20 get into some thorny ground.

21 Let me ask you this. Aside from ECP, do you
22 know of any other references in the economic
23 literature to basing prices on costs avoided?

24 A Well, I don't think that's ECP and I don't
25 think that our prices are really based on something

1 different than -- We say how much cost would we incur
2 for a three digit piece, how much for a five digit
3 piece, how much for a basic carrier route, how much
4 for a saturation carrier route, and prices are based
5 on whichever way you do the arithmetic, the difference
6 moving down or moving up. I don't see the difference.

7 Assuming in both cases that there is some
8 actual behavior decision, who does this, the Postal
9 Service or somebody else? I think that is a sound
10 economic way of looking at the problem. It's not the
11 end. What you need to do after that point is look at
12 the other factors. Even though we don't measure
13 saturation separately, it's possible that the price
14 elasticity would be different. It's different in the
15 sense of being more elastic. That might justify a
16 difference in the unit contribution or effectively in
17 the cost coverage.

18 There is a whole range of possibilities.
19 I'd just say the cost avoided and cost incurred
20 doesn't seem to generate any different implication
21 than if 100 percent pass-through and retained
22 contribution.

23 Q You have no problem in thinking of the 12
24 cent unit contribution being imposed on a 10 cent
25 letter as being a markup on costs incurred, however.

1 A Well, I can do the arithmetic, but I don't
2 know if it was your interrogatory or somebody else's
3 asking about forward distributed cost. I think it was
4 yours.

5 Really, in the Postal Service with its unit
6 cost cost structure, scale and scope, and what follows
7 from that is you've got to charge more than marginal
8 cost in order to break even, which we're also supposed
9 to do, is that you can't, especially with the other
10 criteria met, you can't simply think in terms of the
11 same percentage markup. You've got to look at the
12 best way to do that. Really under the statute, we're
13 looking at the whole country.

14 One of the things that economists will tell
15 you, which hasn't gone very far with the Commission,
16 is that well, we could get there in covering costs, in
17 getting the right division of work sharing. You'll
18 have the least impact on consumer surplus if you -- I
19 think you used it in the interrogatory, but it's
20 basically how much you distort how people spend their
21 money compared to what it costs to produce the things
22 that they're spending it on. We have to get that
23 contribution somehow. Most of the time everybody's
24 price is above cost of production.

25 It's complicated in practice, but the common

1 solution to that is ramsey pricing where the least
2 elastic product is therefore not going to respond to
3 higher prices, so you're not going to distort the
4 amount that's consumed, very much of that product to
5 others. That's a signal that in terms of consumer
6 surplus, all the products including the Postal
7 Service's. You ought to move in that direction
8 anyway.

9 We're not really operating under that
10 environment. We have other pricing criteria that we
11 are specifically directed to consider and which
12 probably rarely will point us in the direction of
13 ramsey pricing.

14 Q There's a certain logic to it, though.

15 A Yes, as an economist I think it's a good
16 insight, and it is something that all things being
17 equal we probably ought to pay attention to, but it's
18 so rare to actually find other things close enough
19 equal that in practice I think we haven't made
20 implicitly or explicitly a whole lot of movement in
21 the direction that straight ramsey prices would
22 indicate.

23 Q Let me finish with one question -- I
24 shouldn't say that.

25 (Laughter).

1 Q Let me finish on page 30 of your testimony.

2 A Okay.

3 Q Lines -- My notes are from your prior
4 testimony so I have to see where you said it on your
5 new testimony.

6 It was lines 15 to 17, now it's lines 21 to
7 23.

8 A Okay.

9 Q with that background I would note that at
10 proposed rates contribution per piece is about the
11 same in ECR and standard regular, both round to ten
12 cents, despite the different cost coverages, correct?

13 A Correct.

14 Q Now my question is, why do you note that?

15 A Because of something I suggested earlier in
16 the day that is that it's my impression that mailers
17 expect the cost coverages to be equal rather than the
18 contributions and these are obviously quite different,
19 especially in the context where something has reduced
20 one cost relative to another or increased it. I think
21 that equal coverages to last time is not a good first
22 step. These are two sub-classes, however, and I don't
23 think that necessarily equal contributions is where we
24 should be aiming because of the differences in the
25 other criteria and the price elasticity, which is

1 something that economists can understand.

2 When I actually wrote that sentence, they
3 didn't both round to ten cents, but they were pretty
4 close together. That was more to focus people's
5 attention on another aspect of looking at
6 contributions of costs, institutional costs, than to
7 lay that out as a per se desirable outcome.

8 Q I guess what I'm trying to get at is not too
9 long ago we had a situation where unit contribution
10 from ECR was above regular, correct?

11 A Correct.

12 Q At that time when ECR mailers raised the
13 issue with the Postal Service of unit contribution we
14 frequently heard the Postal Service say well we don't
15 look at unit contribution.

16 You've heard that said?

17 A I don't know that I have, actually, but I'm
18 not surprised. All of the precedent in terms of rate
19 cases is cost coverages, and the more I have looked at
20 that in the context of the current set of products and
21 especially the rate structures within the sub-classes
22 and the changes that can take place over time, I think
23 getting to look at the contributions in something like
24 cents per piece as well. But coverages, if you're
25 going to compare express mail and standard ECR piece

1 for piece, it isn't worth anything.

2 So the original coverage process which has
3 been continued to this day is important, but it's not
4 the only thing.

5 Q No, but it's just that when you say "I would
6 note that" and you talk about unit contribution which
7 we've been --

8 A Right.

9 Q -- beaten down before on, I was trying to
10 see if this was now a new goal of the Postal Service.

11 A No.

12 Q -- sort of a happenstance of the way the
13 numbers fall out in this case.

14 A It's a happenstance. It wasn't that way
15 quite originally. Even in first class it's not a
16 permanent goal but it was a direction we wanted to
17 move.

18 So --

19 Q Well if you --

20 A I've already said it's a way of focusing
21 people who I believe, maybe wrongly, look at the cost
22 coverages and say if it costs less per piece why is
23 our coverage higher? Because we have to get the
24 contribution.

25 Q And you're the bad guy.

1 A I'm the bad guy, yes. I spread it around,
2 the pain. So that's --

3 Q Taking your comment at face value that
4 obtaining equal contribution per piece of ECR and
5 regular is not a goal of the Postal Service, what in
6 your opinion is the proper relationship between
7 coverage on ECR and coverage on regular?

8 A I don't have an opinion on that in general
9 terms. I think unfortunately, if I relieve the pain
10 somewhere I have to pile it on somebody else and there
11 are always considerations of that sort and the other
12 pricing criteria. We could probably work up an
13 example, all other things being equal what you'd come
14 to. It's going to be because of the assumptions you
15 make, that's all.

16 I would sort of look positively on the fact
17 that it's no longer higher in ECR.

18 Q The unit contribution.

19 A Yeah. Although --

20 Q You're not saying that the markup is no
21 longer higher.

22 A No, no. That's the whole point of the
23 distinction between the markup and the cents per
24 piece.

25 Q I just want to make sure no one misquotes

1 you on the record.

2 A Right.

3 MR. OLSON: Dr. O'Hara, thank you so much.
4 I appreciate your help today.

5 Thank you, Mr. Chairman.

6 CHAIRMAN OMAS: Thank you, Mr. Olson.

7 Is there anyone else who wishes to cross-
8 examine?

9 Mr. McLaughlin.

10 MR. McLAUGHLIN: Thank you, Mr. Chairman.
11 This is in the nature of a followup.

12 CHAIRMAN OMAS: I meant to say followup.

13 CROSS-EXAMINATION BY ADVO

14 BY MR. McLAUGHLIN:

15 Q My name is Tom McLaughlin representing Advo.
16 I just have a couple of questions that I've kind of
17 written down on my little notepad as I've been going
18 through the day, so bear with me while I kind of flip
19 through.

20 I'd like to start first with some questions
21 I think Mr. Baker had about your Exhibit 31(b).

22 A Okay.

23 Q I believe he was focusing on the changes you
24 had made and also on the revenue and cost coverage
25 numbers. I just wanted to get some clarification from

1 you.

2 If you look at the first column of numbers,
3 the volume variable cost, and look down at enhanced
4 carrier route. Am I correct in assuming that that
5 volume variable cost assumes that no DAL mailings
6 convert from DAL to --

7 A That's correct.

8 Q So that would not include any cost savings -
9 -

10 A Right.

11 Q -- due to that conversion.

12 A Right.

13 You have the revenue now, but not initially,
14 to reflect the additional costs that would incur if
15 that happened to be the case.

16 Q I'd like to refer you to ValPak
17 Interrogatory 9. It was the table at the end, page
18 two. I believe there again you had some discussions
19 with, I believe it was Mr. Baker, concerning that
20 table.

21 A Yes, I think so.

22 Q You showed on there a dotted line that you
23 wrote in between the years I think '96 and '97 and you
24 explained that that was due to the fact that there had
25 been methodological changes in the way costs were

1 allocated among classes that in essence changed what
2 had been done before.

3 A Those were the Postal Service's change to a
4 measured volume variability, meaning processing that
5 was lower than the Commission and the Postal Service
6 had used previously. So the effect of that would take
7 volume variable costs out of the system and move them
8 to institutional costs. So it's not precisely the
9 same as the other things I've been talking about, but
10 it does result in an increase in coverages which you
11 can see across the board there of more than a few
12 percentage points.

13 Q Did that also have the effect of changes to
14 some extent between sub-classes to the extent that
15 some classes might have been more affected by that
16 change and others less affected?

17 A Yes. Generally speaking I would expect the
18 classes that had a greater portion of their costs in
19 mail processing would have been more affected.

20 Q And likewise over the years I take it there
21 have been several methodology changes either in
22 carrier costs or IOCS costs or data collection or
23 transportation costs, other kinds of costs where it
24 isn't that costs have suddenly appeared, it's that
25 they've sort of been reshuffled or reallocated among

1 classes or categories because of just new studies.

2 A I'm sorry.

3 Q They've just been reallocated among classes
4 because of new studies.

5 A New studies, yes. And sometime reallocated
6 from, in small ways at least, from volume variable
7 institutional. I don't think that's much of the trend
8 since the dotted line, but it was a big part of the
9 dotted line.

10 Q But that does have some affect on cost
11 coverage relationships.

12 A Yes. It can. If you take into account,
13 look at cost coverages as you thought they were and
14 cost coverages with the new whatever methodology,
15 statistically new studies, new software in the IOCS,
16 tally-takers device, I don't know what else to call
17 it.

18 All those things will tend to affect the
19 distribution of volume variable costs across classes
20 and --

21 Q Well as a pricing witness in setting prices,
22 if there's been some methodological change, either due
23 to the way data is collected or the way it's studied
24 and allocated, you wouldn't automatically apply the
25 historical cost coverage to those new costs to develop

1 rates, would you?

2 A No.

3 Q Wouldn't you take into account the fact that
4 there have been cost reallocations in deciding what
5 the --

6 A Yeah, that usually shows up most directly
7 in, if you were to start with the previous cost
8 coverages which we don't necessarily do, but if you
9 did you would find that you had a big rate increase
10 for the sub-classes that had costs shifted to them and
11 a rate decrease of some to the sub-classes that had
12 costs shifted away from them, and you would look at
13 those and realize, if you hadn't before, that that's
14 due to the methodological change in the cost
15 measurement and not wholly at least into the actual
16 patterns of the way we spend money, if you will, or
17 incur costs.

18 Q When you look at the bottom of page two,
19 ValPak Interrogatory 9, where you have an index of
20 those cost coverage relationships, whether it's a cost
21 coverage index or a Commission type markup index.

22 A Yeah.

23 Q You would expect there would be changes in
24 those relationships from year to year perhaps due to
25 things like changes in methodologies or --

1 A Yes.

2 Q -- collection.

3 A Yes. That's always a factor before you
4 start worrying about, or thinking about what costs
5 coverage to apply, you need to know what else has
6 happened. It's not often as dramatic as the '96-'97
7 line, but for an individual class it certainly has
8 happened quite recently. Some change in the software
9 for how periodicals were -- for a piece of mail
10 identified as being a periodical or not by the data
11 collector changed. We got new tools and the memory in
12 the tool was much greater, as it is with everything
13 these days. So whereas the earlier software had had a
14 list of publications that was maybe several hundred
15 long, don't take that number as right, and if a data
16 collector found that a publication that was on that
17 list or he thought might be on the list he could check
18 it against the list in some manner very quickly and
19 it's a periodical, okay. If it didn't make the list
20 but it still looks like a periodical, then there are
21 other things that are supposed to happen. You look
22 inside for the publisher's statement and so on.

23 But with the new machine device, they were
24 able to put five or ten times as many titles in the
25 software so the look-up would signal a match for a

1 much larger number of pieces, at least it's not a
2 huge, absolute number but in percentage terms it was
3 enough to move costs that had been somewhere else onto
4 periodicals. So that was one example which may not
5 even be periodicals on this chart, but it was
6 certainly big enough to be of concern to them and to
7 us to make sure we understood that that was a change
8 in measurement and not just actual increase in
9 resource usage for periodicals.

10 Q The bottom line though is that when you're
11 looking at an index like that and you're looking at a
12 trend or you're looking from one year to the next, you
13 wouldn't just automatically apply one year's index to
14 the next rate case.

15 A No.

16 Q You would want to know what had happened,
17 what changes had been, what were the underlying
18 reasons?

19 A Yes, absolutely.

20 Q And, for example, do you know for example
21 whether there have been changes in methodology that
22 relate to enhanced carrier route mailings?

23 A I understand without knowing in great detail
24 that the IOCS data collector improvements in the way
25 we do things had several steps to it. One of them, in

1 line with a lot of other non-postal work, is instead
2 of asking the data collector to cite what sub-class a
3 mail piece is in, we did this in the -- You ask them
4 to note everything that's on the piece or on the
5 container. Then you can use computer algorithms to
6 look at those and make the decision internally
7 subject, I'm sure, to review without, depending on the
8 data collector having the detailed knowledge that
9 might be necessary to make a decision.

10 My understanding is that that happened with
11 respect to container movements in standard mail. That
12 as you sort of suggested, the ECR portion has got
13 relatively little mail processing cost, but a lot of
14 it is container movements, packs or pallets. And by
15 making this change in the software, it was intended to
16 and did improve the accuracy. It also seems to have
17 identified more pieces as ECR, more than the previous
18 process did.

19 Q Mr. McKeever was asking questions in general
20 about the Commission's approach to markup indices. I
21 believe he was trying to get you to say that the
22 Commission preferred, or I'll use the word --

23 A I confirmed that.

24 Q -- preferred using markup indices.

25 A Yeah.

1 Q Do you know whether the Commission has
2 strenuously adhered to markup indices in past rate
3 cases? Or did in fact recognize that there is a need
4 to depart from indices and --

5 A Certainly they don't rigorously apply them
6 mechanically. They publish the history in every case,
7 and I think you can look at that and see, I probably
8 still have the cost examination exhibit here, that
9 they change from year to year, whether it's a markup
10 or a cost coverage index. That's the action of
11 consideration of everything.

12 If it's a methodology change, if it's
13 something that has happened, in one of my examples I
14 suggest that sometimes we make a big technology
15 investment that only helps letters. And if you're a
16 periodical and don't have any appreciable number of
17 letters that's going to keep your costs from getting
18 as much savings, the sort of restraint against cost
19 increases, relative to first class mail or anything
20 else which has a substantial number of letters in it.
21 And I'm sure that, well, you can see considerable
22 variations in this.

23 So whether or not you're using one
24 particular index or another, I did say they're going
25 to point you generally in the same direction and I'd

1 prefer the coverage index only because I think it's a
2 more precise indication in many circumstances.

3 But you can see that either one, and if you
4 looked at a similar thing for the Postal Service you'd
5 see the same thing, nobody applies it rigorously and
6 for good reason, I would say.

7 Q In other words it's not a mechanical tool.

8 A No.

9 Q It's the sort of tool that you use to look
10 at and then you make your best judgment of what the
11 best rates are.

12 A Yes. You understand what causes
13 underlying --

14 Q Mr. Olson for ValPak asked you some
15 questions that went a little bit beyond the class
16 versus class level. He was talking a little bit about
17 pricing in sub-class.

18 Within a sub-class like ECR do you believe
19 that all the kinds of products within ECR are
20 homogenous in terms of their market characteristics?
21 Or are there in fact, even within the sub-class level?

22 A It's certainly possible that they vary.

23 Q I could give you an example. I believe his
24 example was an ECR saturation letter entered at
25 destination and an original parcel.

1 A Oh, yes. That clearly is, as I said, no
2 matter how we arrange the rate relationship very few
3 people are going to even think about changing a parcel
4 into a letter.

5 Q And you wouldn't think that the market
6 characteristics, demand characteristics, whatever, in
7 the marketplace competitive environment, or that
8 origin parcel mailer would necessarily be the same as
9 for that saturation --

10 A Yes.

11 Q -- destination --

12 A Absolutely, yes. There is no reason that I
13 would assume they ought to be the same or even all
14 that closely interrelated.

15 Q Now when you're looking at that as a pricing
16 witness, he was giving you the example of a saturation
17 letter costing ten cents and the origin parcel costing
18 90 cents, and the question was, knowing the cost, what
19 should you do about the rate.

20 I believe he was talking just in very
21 general terms about two choices. One was equal
22 markup, one was equal unit contribution. And if, for
23 example, you just did the equal unit contribution and
24 you added, say for example, ten cents to each, the
25 letter would go to 20 cents and the parcel would go to

1 a dollar.

2 A Uh huh.

3 Q If you used 100 percent cost coverage, the
4 letter would go to 20 cents and a parcel would go to
5 \$1.80.

6 A Right, 100 percent markup.

7 Q Wouldn't you as a pricing witness want to
8 have at least some comfort level that those parcel
9 mailers were willing and able to pay \$1.80 and that
10 they wouldn't just leave the system if the price were
11 too high?

12 A That's always a risk in every class, and you
13 see it in the Diga. The forecast says that we're not
14 going to get quite as much growth in the after-rates
15 version of the years of before rates, and that's true.
16 There's good reason for that forecast taking that
17 shape.

18 Q Do you think that either the Postal Service
19 or the Rate Commission ought to ignore market
20 characteristics within --

21 A Not at all. We talk of market
22 characteristics most of the time in terms of price
23 elasticities, but there are other things as well that
24 really fall under that umbrella. They may be less
25 easily measured, they may be, even the elasticity, we

1 measure it, but exactly how you should adjust rate is
2 not obvious.

3 So yeah. I was remarking earlier that, in
4 an individual conversation, that I really thought that
5 for all the disagreement possible about what the
6 markups or the coverages or the end contributions
7 should be, that we've got one pricing criteria that
8 addresses costs, so we take care of the volume
9 variable part with that one. All the rest are about
10 the institution cost. Not because of anything I've
11 done, but just looking back and knowing what I do
12 about the last ten years, I think the outcome has been
13 pretty reasonable in balancing all these
14 considerations.

15 I wouldn't be one to advocate switching to a
16 pure, let's maximize our profits if we had one, or
17 let's at least adhere strictly to lengthy pricing.
18 The law doesn't tell us to do that and I think there
19 are good reasons that the law is that way.

20 MR. McLAUGHLIN: Mr. Chairman, I have no
21 further questions.

22 CHAIRMAN OMAS: Is there any additional
23 followup cross-examination for Witness O'Hara?

24 Mr. McKeever, I thought you were going to
25 come up.

1 MR. MCKEEVER: I was, Mr. Chairman, but I
2 don't see any need for followup.

3 CHAIRMAN OMAS: Thank you. I saw you get up
4 earlier.

5 With that, Mr. Tidwell, would you like some
6 time with your witness?

7 MR. TIDWELL: Could we have ten minutes, Mr.
8 Chairman?

9 CHAIRMAN OMAS: Yes. Let's come back at ten
10 after 3:00.

11 (Whereupon from 3:00 to 3:12 p.m. a recess
12 was taken.)

13 CHAIRMAN OMAS: Mr. Tidwell?

14 MR. TIDWELL: Mr. Chairman, the Postal
15 Service has no questions.

16 CHAIRMAN OMAS: My goodness. Thank you, Mr.
17 Tidwell.

18 That being the case, Mr. O'Hara, we thank
19 you for your testimony here today. That completes
20 your appearance. And we appreciate your contributions
21 again to the case. You are now excused.

22 (Whereupon, the witness was excused).

23 CHAIRMAN OMAS: This concludes hearings on
24 the Postal Service's direct case. Hearings will
25 resume on October 23rd to receive evidence of the

1 Intervenors.

2 We now stand adjourned. Thank you very
3 much.

4 (Whereupon, at 3:13 p.m. the hearing was
5 recessed, to reconvene on Monday, October 23, 2006.)

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REPORTER'S CERTIFICATE

DOCKET NO.: R.2006-1
CASE TITLE: Postal Rate and Fee Changes
HEARING DATE: 8/30/06
LOCATION: Washington DC

I hereby certify that the proceedings and evidence are contained fully and accurately on the tapes and notes reported by me at the hearing in the above case before the Postal Rate Commission

Date: 8/30/06

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